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Letter of the Editor   June 25, 2015

Dear Financial Executive,

You receive the **IAFEI Quarterly XXIX th Issue**.

This is another issue of the **IAFEI Quarterly**, the electronic professional journal of IAFEI, the International Association of Financial Executives Institutes.

This journal, other than the IAFEI Website, is the internal ongoing information tool of our association,

destined to reach the desk of each financial executive,
or reach him, her otherwise,
at the discretion of the national IAFEI member institutes.

This issue contains a broad variety of articles on accounting, financial and tax matters from 7 countries, respectively country groups, and from very diverse sources.

This issue has been made more user friendly. From the table of content you can now directly click into every article, without scrolling through the entire issue.

Once again:

I repeat our ongoing invitation, to IAFEI member institutes, and to their members,
to send us articles for inclusion in future IAFEI Quarterlies, and to also send to us your suggestions for improvements.

With best personal regards

Helmut Schnabel

Silver Sponsor of IAFEI, the International Association of Financial Executives Institutes:

(1 September 2014 to 31 August 2015)

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-
by transferring the risk to the insurance market

CREDIT FINANCING
-
by assigning trade receivables to a bank or factor

CREDIT MANAGEMENT
-
by optimising credit management tools

It is the sponsorship policy of IAFEI, to thereby enhance the value of the organization to is member institutes and its individual financial executives members, around the world, while, at the same time, entering into a professional dialogue, by various ways and means, with the sponsoring corporations. In so doing, IAFEI is striving for having such corporations as sponsors, which are world class corporations, and among the best in their business sector, and with a truly global scope and focus of activities. Thus, IAFEI and its sponsors, want to jointly serve financial executives, worldwide, for their professional benefit.

A foothold in China

FREE TRADE ZONES IN THE WORLD'S SECOND-LARGEST ECONOMY OFFER LIBERAL FINANCIAL AND TRADE POLICIES, AIDED BY MODERN INFRASTRUCTURE AND SUPPORTING BUSINESSES, SAY YANG DU AND EASON SHI

The first wave of overseas investment in China began in the 1990s. Those early adopters saw the potential of the Chinese market and its vast population. Twenty-five years later, the second wave of international investment has begun, prompted largely by the Chinese government's establishment of free trade zones.

In the past, international investment in China has been limited for a number of reasons. These include: all investment being restricted and subject to approval; the Chinese not being allowed to own foreign debt; and the Chinese capital markets not being open to foreign investors.

The slowdown in China's GDP growth over the past 10 years has led the Chinese government to introduce an alternative strategy, however. It has adopted internal financial reform and a process to internationalise its currency, the renminbi. As a result, the focus of the People's Bank of China is to increase the liquidity and circulation of the renminbi, increase its usage internationally and then progress its convertibility.

A key part of China's financial reforms is the establishment of free trade zones, which are designed to test the impact of free market reform and the liberalisation of FX policies on the Chinese economy before these are rolled out to the rest of China. It is hoped that the free trade zones will accelerate the liberalisation of the financial sector, increase cross-border trade and investment flows, and boost growth in domestic services and innovation. The first free trade zone, which was established in September 2013 in Shanghai and its surrounding area, is 120.7km² in size.

Specifically, the pilot free trade zones (PFTZs) aim to:

- Promote free trade;
- Progress financial reform;
- Simplify administration;
- Upgrade customs procedures;
- Open up China's investment sector;
- Create a competitive regulatory and tax environment; and
- Operate as a test market for national reform.

The Shanghai Free Trade Zone is a leader in financial services, with multiple international banks, and domestic Chinese banks using it as their headquarters in China. Other service industries in the free trade zone include shipping services, business services, professional services, and cultural and social services.

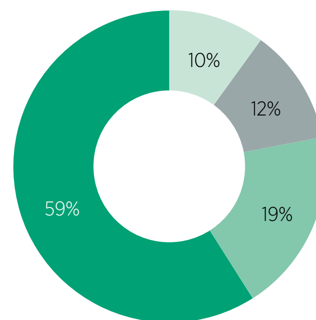
Furthermore, the Shanghai Free Trade Zone has attracted some large multinational companies, including technology giants Microsoft and Sony. Some 90% of companies in the zone are Chinese and they are benefiting from the liberal policies for outward investment.

Following in Shanghai's footsteps

Earlier this year, China unveiled three new free trade zones that are modelled on Shanghai, but have different local economies and geographies.

Tianjin Free Trade Zone has been established to operate as a gateway to the economic zone in northern China. Its industries include aerospace, automotive, financial leasing, high-end manufacturing, petrochemicals, pharmaceuticals, metals and mobile phones. With modern infrastructure including Tianjin Port (the largest port in northern China) and Tianjin Airport, it is expected

SHANGHAI FREE TRADE ZONE IN NUMBERS



- Trading **59%**
- Service **19%**
- Manufacturing and R&D **12%**
- Foreign-owned **10%**

23,000 companies

47 banks

300,000 workers

to boost the economies in Beijing, Tianjin and the Hebei Province, and support developing trade relations with Japan and South Korea.

Fujian Free Trade Zone has specialist industries including electronics, petrochemicals and mechanics. It also operates as the logistics centre for southern China, which is developing new railways, ports and highways. It is a major strategic zone for trade with, and investment from, Taiwan.

Guangdong Free Trade Zone has a wide range of industries, including automotive, building materials, electrical machinery, electronics, food and beverages, petrochemicals, pharmaceuticals and textiles. Its primary focus is to develop financial services and customs clearance. Due to its location, it is expected to further relations with Hong Kong and Macau, ultimately further connecting China with Southeast Asia, Africa and Europe. Shenzhen Free Trade Zone, which was approved by China's State Council in April 2015, is a part of the Guangdong Free Trade Zone.

Key benefits

Free trade zones offer many benefits to both domestic Chinese and international companies. These include:

1. **Simplified business processes.** Establishing your business involves reduced administration and more lenient processes. If your business sector is not on the 'Negative List', then it only takes seven working days to receive all the licences necessary to start operations. By comparison, establishing a business outside the free trade zones takes approximately 30 working days. The Negative List is a list created by the Chinese government of 122 items that foreign companies are not allowed to invest in. To see the list, visit www.shanghaifreetradezone.org/en/Negative_List.pdf
2. **Simplified outbound investment management.** Filings for domestic companies take five days for outbound investment, and one day for FX and payments. Outside a free trade zone, filings can take up to five months.
3. **Reduced customs procedures.** Imports are held in the free trade zone without inspection until the goods are sent to the domestic market, which reduces import times.
4. **Financial innovation.** There are many financial benefits, which include the operation of a renminbi cash pool, a foreign currency cash pool, centralised FX operations, the removal of government restrictions on FX and access to the interbank markets.
5. **Preferential interest rates.** Banks in the free trade zones are able to offer preferential rates, meaning businesses may be able to negotiate a rate less than the 6% offered in the rest of China.
6. **Preferential tax rates.** In some zones, tax treatment is different from the domestic market. For example, in the Shenzhen Free Trade Zone, tax is 15%, compared with the 25% domestic tax rate.

Given these benefits, it is clear that any company looking to do business in China should consider locating to a free trade zone.

For more information on free trade zones, visit **www.shanghaifreetradezone.org/en/index.htm**

Or view the ACT webinar, Exploring the impact of free trade reform in China, sponsored by Thomson Reuters, at **www.treasurers.org/freetradereform**

WHAT DOES IT MEAN FOR PRIVATE BUSINESSES?

	China	Shenzhen (PFTZ)	Shanghai (PFTZ)	Hong Kong
Interest rate	6%	5%+	5%+	5%+
Corporation tax rate	25%	15%	25%	15%
Individual tax rate	3%-45%	3%-45%	45%	15%
VAT	13%-17%			
Renminbi trading	Yes	Yes	Yes	No
Can the initial capital injection be returned?	No	Yes	Yes	Yes

Having the ability to operate cash pools and to move cash simply in and out of China are notable advantages. More than 60 companies are operating a foreign currency pool in the Shanghai Free Trade Zone, while more than 140 have a renminbi pool. In a free trade zone, a company that uses a cash pool can remit foreign currency freely without worrying about FX controls.

Key considerations for international investors

While there are many reasons for international investors to choose to locate in a free trade zone, it should be acknowledged that the regulation in operation within a free trade zone is different from that in the rest of China. Since these liberal policies are not guaranteed, there is always a risk that the central government could change the free trade zone policies if it considers them potentially inappropriate for the rest of China.

In order for a company to benefit from free trade zone policies it must have a registered office in the zone. Free trade zones are suitable for both large and small companies, but any international investor must make a capital commitment that is based on their operational forecast and specified in their articles of association. The capital is not actually required at inception (only the goodwill of the initial capital is registered), so the paperwork for setting up an office in a free trade zone can be completed before payment is made. If your company has other entities in China, it should consider establishing a holding company in a free trade zone. Payments in free trade zones are usually made in renminbi.

Your choice of free trade zone will depend on the industry in which you operate (different zones have specialist industries), your geographical focus (both in China and the surrounding countries/territories) and any operations you may have already located in China.

Yang Du is head of China Desk at Thomson Reuters and **Eason Shi** is senior manager at Shanghai Waigaoqiao Free Trade Zone United Development Company

With thanks to Jessica Zhang, senior manager, Shanghai UDC Business Consulting Company

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Press Release

Dagong Europe Publishes Commentary: China's Foreign Investments at a Record High - Europe Gaining Importance

Milan, 21 April 2015

Dagong Europe has published a commentary entitled China's Foreign Investments at a Record High - Europe Gaining Importance. The research is available to read on www.dagongeurope.com.

The new report analyses the dynamics and progress of Chinese outward foreign direct investment (OFDI), identifies the major drivers, and focuses on the position and future role of Europe as a growing recipient of Chinese capital.

"Global expansion has risen to the top of China's agenda" says Richard Miratsky, Head of Corporates Analytical Team at Dagong Europe. "Its foreign investments are expected to pass USD 120Bn in 2014, the highest ever. We expect this strong growing trend to continue, highlighting China's aspiration to invest USD 1.25Tn abroad over the next decade."

Chinese investment in Europe peaked at USD 18Bn in 2014. "Utilities and high-tech sectors are definitely holding the attention of Chinese investors, but we see food and agriculture, commercial real estate and leisure and luxury gaining momentum in the medium term", adds Mr Miratsky.

Key findings:

- **China's growing foreign investments expected to continue:** China is expected to report a historic peak in foreign investment at over USD 120Bn in 2014. China has been the world's 3rd largest foreign investor since 2013, after the US and Japan, moving up from 33rd position in 2000.
- **Focus on high-tech investments drives China's capital in Europe:** The desire to overcome its comparative disadvantage in high-tech sectors has led to the growing trend in China's investments in the utility, energy and manufacturing sectors in Europe. In the medium to long term there will be an increasing focus on sectors like food and agriculture, commercial real estate and leisure and luxury.
- **China's investments in Europe hit a record high in 2014:** Chinese OFDI in Europe reached USD 18Bn in 2014. Although crisis-driven low valuations on assets are still an important driver, the increasing investments in sectors and countries where assets no longer appear under-priced suggests that this is a structural trend, not just a cyclical phenomenon.
- **China to invest USD 1.25Tn overseas in the next decade:** At the end of 2013 China had accumulated USD 660Bn in OFDIs. This figure is set to grow further as global expansion has risen on the agenda of China's political establishment. It has set a goal of USD 1.25Tn to be invested outside the country over the next decade.

Disclaimer

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European Union,
Article: Point of View: Fair Play at Corporate Taxes - Now

By **Valdis Dombrowskis**, Vice President of European Union Commission,
and by **Pierre Moscovici**, European Union Commissioner for Economic and Financial Affairs,
from Frankfurter Allgemeine Zeitung, Frankfurt, Germany, June 17, 2015

Some companies in Europe are playing a game, which runs counter to all principles of fair play. Let us call it "Taxes do not annoy me!." The objective is simple: It is all about paying as few taxes as possible. Some companies are playing it more skilfully and without scruples than others. But today we are changing the rules of the game. It is now about jobs, growth and investments. We want Fair Play and equal starting conditions for all corporations.

Tax avoidance is costing the European Union Member States billions of public money. They are competing for profits of corporations without shaping their tax policy in a growth-friendly way. For all of those, who are paying their taxes, this has devastating consequences. Smaller companies which are not operating beyond borders, are paying a high price for the misusing tax practices of some of their greater competitors. Corporations which are not exercising tax avoidance are disadvantaged versus the other ones. In short: the tax system of today is attractive for corporations which want to avoid taxes. Many others who are actively investing in the European Union and creating jobs are burdened with this.

Our citizens – the tax burden of whom has increased as a consequence of the crisis – understandably do not any longer accept that some of the richest corporations in the world pay little or no taxes at all. This lack of tax justice is not only endangering the social contract between state and citizen, but also our European economic model. The European Union undertakes great efforts in order to enhance jobs, growth and investments. The taxing of corporations should contribute to this. This, however, is not always the case.

The problem can only be solved with a basic comprehensive reform of the taxation of corporations. Our tax law dates back to the 1930's and must be urgently modernized. Legal gaps and legal ways of tax avoidance must be eliminated. The states must understand that going their own way with tax politics and with an unlimited tax competition does cause more damage than benefit. If we want to eliminate tax avoidance and we want to create a tax system which is allowing growth and investment, then we need a new taxing scheme for corporations in Europe which also applies uniformly: The concept which makes possible a just and effective taxation and which supports all corporations in the internal market. Multinational groups should not pay more and less than domestic corporations.

The action plan which has been presented today by the European commission for the reform of the corporation taxation is based on three fundamental principles which each tax policy in future must pay heed to:

First: Corporations which achieve profits in the European Union, must pay taxes on these profits also in the European Union. The fact that multinational corporations move around their profits in the internal market and then transfer them in tax heavens cannot any longer be accepted.

Second: The taxes paid by the corporations in the European Union must be just from the point of view of size, and must start from the location where the corporations are effectively operating. It must be forbidden to corporations to make use of legal loopholes and tax incentives in order to reduce their entire taxable income in the European Union to a small amount.

Third: The corporation taxes must support the European agenda for investments and jobs, they must not undermine it. Taxing hindrances must be eliminated, in order to create equal starting conditions for all enterprises – small ones as well as big ones. The tax base must be broadened and we need real incentives for real investments.

The heart peace of our action plan is the restart of the proposal for a joint common consolidated corporate tax base (CCCTB), which the Commission has already presented in 2011. The CCCTB is offering to the corporations one single system for the computation of their profits which are taxable in the European Union instead of in the 28 national tax systems. It is of benefit for small and medium sized as well as for multinational corporations. Corporations which are also active in other member states of the European Union can save one billion Euro of compliance costs and uncountable hours of administrative work.

By summarizing all profits which a corporation is achieving in the European Union, then with the CCCTB not only goes away an opportunity for a misusing tax avoidance.

Up to then we must take care of the most urging problems of our corporation tax systems. We want to reform the corporate tax law, we want to limit the low taxation and no taxation and we want to better safeguard against tax fraud. We shall also take care in Europe for better regulations about transfer prices and about tax incentives for profits from intellectual property, which is responsible for 70 % of profit shifting in the European Union. Misusing practices must be finished.

We want to strengthen the internal market for multinational corporations which are abiding to the regulations: Where different member states continue to tax twice, there must be procedures in order to finish this.

Not least, we are working for tax transparency which is indispensable for fairer and more open taxation of corporations. In March we have also proposed an automatic information exchange about advance tax assessments between European Union member states. We now want to carry this transparency program one step further and extend it beyond the European

Union. We need especially a clearer and more uniform European Union strategy towards tax heavens. We must act better against dangers for the states´ tax income from the outside.

The European Commission – for this reason – is publishing today the "Top 30" – third states, which are put on the black list by the European Union member states. This is an efficient deterring for non cooperating states and it will pave the way for a more explicit procedure against them by the European Union.

Together, these steps can decisively improve the tax framework conditions for corporations in Europe and make it more just from the point of view of the citizens. But we will only attain this objective if the European Union member states contribute and support the new initiatives. Our target is to take care for jobs, growth, and investments in Europe. We do everything possible to create fair and transparent regulations and equal starting conditions in order to newly open up the game.

In 2014, the discussion about aggressive tax planning was still controversial. In 2015, the agenda must say: "The game is over!."

from Frankfurter Allgemeine Zeitung, Frankfurt, Germany, June 17, 2015, Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

European Union,
Presentation:

The European Union, the Euro, Greece, the ECB, Quantitative Easing: Challenges for the Treasurer. Where Do We Go From Here?

By Helmut Schnabel, Managing Director Asecuris Asset Management Advisory GmbH, Chairman GEFIU, Association of Chief Financial Officers Germany

Ladies and Gentlemen,

Seven years after the great financial crisis, the politicians, the European people, and the business community are still dealing with the following great challenges for the countries, for the economies, and for the corporations:

- how can the over-indebtedness of states be contained?

-how stable or unstable is the common currency, the Euro?

-how do the European States get out of recession, and regain stability and growth?

-will ultra-low interest rates be the cure for all financial problems and challenges?

Daily, we are confronted with comments to these issues and questions, from all involved parties, and more than ever we need a compass which guides us through this daily flood of such comments and opinions, as to what will be the best solutions for the ongoing challenges.

Let me start with touching upon the Euro. We are all aware, of what the foundations of the Euro are: It is to be a stable, strong and joint currency of the European countries, which participate in the Euro, it is a part of our European identity, which can be felt in our hands and pockets, daily, and, most of all, it symbolises the will and desire of all participating countries, after centuries of war, to live and work peacefully together for the joint common political and economic advantage and benefit. This mission and vision is also the ground layer of the European Union, constituted by 29 European Member countries.

But no instrument demonstrates this daily so intensely to everybody, as does the joint currency the Euro.

Why then, has the Euro become, as of today, a phenomenon of so much dispute between the Euroland member countries. What went wrong? The brief answer is this:

The creation of the common currency, the Euro, implies, that the participating countries have given away part of their sovereignty, meaning they stopped having their own currency and own central bank , and own monetary currency policy,

While, at the same time, maintaining sovereignty in other economic spheres, such as first of all the own fiscal policy of a sovereign state.

As all economic policies are interlinked, it was clear from the beginning, that the joint currency can only be successful, if there is also harmonisation of all other economic policies, at least to some degree.

And so the famous Maastricht Treaty was created, which not only defines the basics of the Euro, but which also defines criteria for economic stability, which itself then is the prerequisite of economic growth of the participating countries. The basics of this are in a nutshell:

-the yearly deficit of the government budget of a member state should not exceed 3 % of GDP

-the government indebtedness should not exceed 60 % of the GDP

-no member state should be held liable for the government debt of the other participating states, and thus there should not be any forced flow of money from one government to the other one in order to balance off government deficits. In short, Euroland should not be a Transfer Union.

-and last but not least, the European Central bank is not allowed, to finance the governments of states.

In summary, and to put it differently:
-the Euro is meant to be as stable and strong as the former DeutschMark.
-the European Central Bank is meant to be as independent from politics, as is the German Bundesbank/ German Central Bank independent from politics.

The history is known. By the nature of the Euro construction, the Euro can only function successfully, if the participating states have the discipline and the political will, to abide to the Maastricht Treaty criteria.

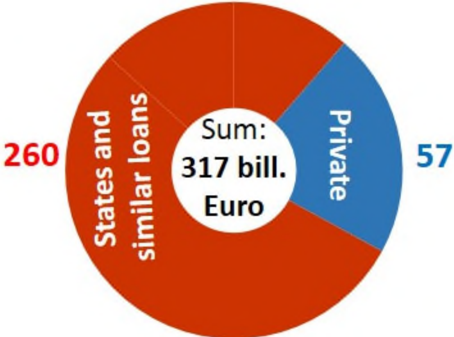
It took only 3 years until 2003, that 2 major states, Germany and France, broke the rule of not exceeding the 3 % annual government budget deficit, and since then, again and again this rule, and also other rules (!), have been broken by the same 2 countries and by many other Euroland member countries. To the degree, that rule breaking has become common place.

Worse than that, from the beginning, 2 states were admitted to the Euro, Belgium (118%) and Italy (126%), which had government debt outstanding of over 100 % of GDP. Promises to bring this down considerably over time, have not been fulfilled, to the contrary, government debt was expanded in Italy towards 132 % of GDP, (Belgium now 107%).

And then came the great financial crisis 2008 to 2009, when many European countries had to bail out failed banks, and when governments did that by incurring huge additional debts, which had not been thought of before and budgeted before, and which led to the effect, that the governments of Euroland are now higher indebted and leveraged, than ever before since WorldWar 2nd, and way beyond the Maastricht Criteria.

Then in 2010 and in 2012 came the Greek Crises, and the tedious and painful effort of the other Euroland countries, to help out Greece from the brink of insolvency and bankruptcy, by installing a great bail out architecture which as of present looks like this:

Greece: Majority of Government Debts are Support Loans from mainly other European States
in billion Euro



EFSF / ESM (Euro Bailout Rescue Fund)	142
States of Euro Area (bilateral, 1st Rescue Program)	53
IMF	35
European Central Bank	30
TOTAL	**260**

-the total of Greek government debt is at **317** billion €

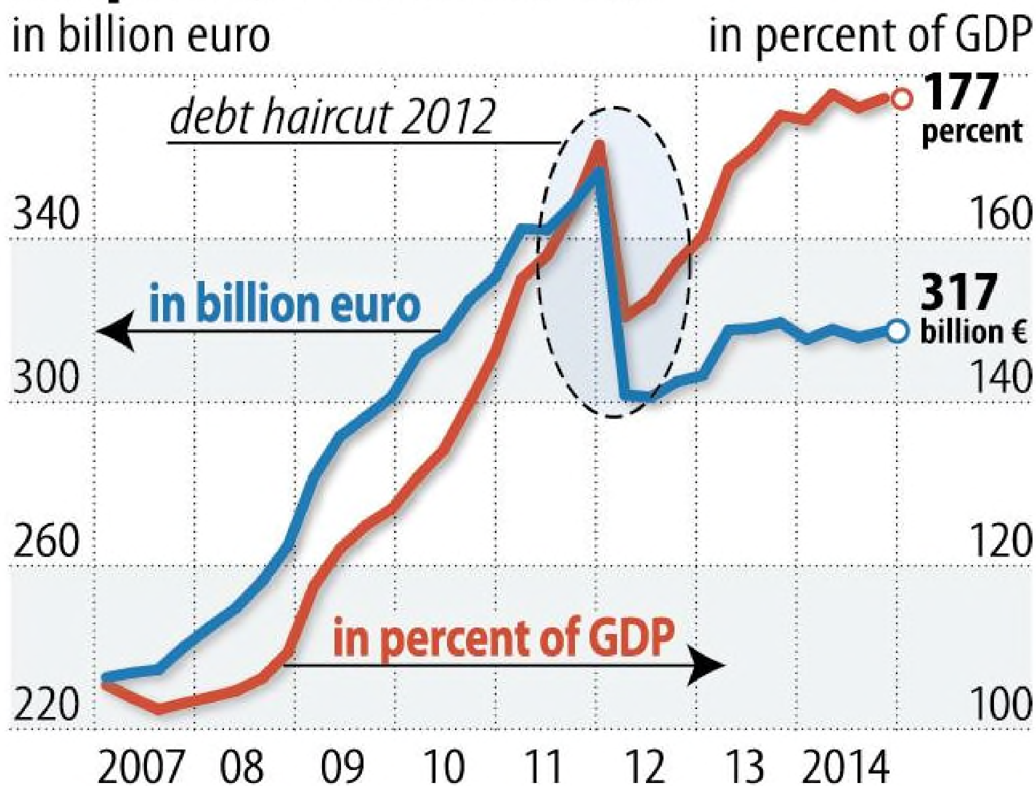
-of the **317** Billion € government debt, 82 %, or **260** billion €, is from the 2 bailout programs, from 2010 and from March 2012, from creditors who are Euroland countries, the ECB, and the IMF

-of the **260** billion €, three quarters, or **195** Billion €, is from the other Euroland countries and the Euro Bailout fund EFSF/ ESM, which has been set up by such Euroland countries

-the ECB holds **30** billion € of Greek debt

-the IMF holds **35** billion € of Greek debt.

There already has been a debt-hair-cut for Greek government debt, in November 2012, by the amount of **105** billion € from private creditors.



And there has been a second quasi debt-hair-cut in 2013 relating to the 142 billion € bailout loans from the ESM Bailout fund, which looks like this: Deferring most of the interest payments on such loans until 2022, and requesting no instalment repayments until 2022.

increasing the average maturity of such loans by 15 years to 30 years; with the last repayment instalment to be made after 45 years, in 2057.

lowering the interest rate on such loans by one full percentage point to now only libor plus 50 basispoints, which presently makes an interest rate of 60 basis points only.

The total amount of this preferential treatment, expressed in present value, is **47** billion €, and a second quasi debt-hair-cut, at the expense of the European taxpayer.

In spite of this, the present Greek government debt level is again at 1**77** % of GDP, and way beyond the Maastricht criteria of 60 % of GDP.

Many believe, that Greece cannot shoulder and service this debt level, and that another 3 rd debt haircut will be necessary. In the case of Greece, 2 handicaps are coming together:

One, the government over-indebtedness.

Two, the lack of competitiveness of the Greek economy in the globalised world market.

Usually, the market reaction to this would be, that the domestic currency of Greece, formerly the Drachma, would be weakening, there would be a devaluation of the currency, which would then at least remedy part of the insufficient competitiveness in the world market.

As Greece is not having its own currency any more, therefore, what is called the external devaluation of the Greek currency, and of Greece, is not possible any more.

Therefore, the only way out of the dilemma for Greece, is the so-called internal devaluation, meaning the lowering of costs of production in Greece, among which the most important one is the lowering of wages in Greece.

This as everybody knows, and as everybody sees now, is tough to do. But with fairness, we should remember, that Greece, after joining the Euro, excessively increased its wages and other categories of costs, including the costs of an inefficient government and tax administration, and it is itself and alone responsible for having lost its international competitiveness.

So again, what remains to do, is the inner devaluation for Greece, as have successfully done the Baltic States, and to some degree as well Ireland and Portugal.

But the new Greek government refuses to do so, it refuses to do the reforms, which the donating countries are requesting from Greece, and which the preceding government was on the way to carry out.

The tragedy is, that the preceding Greek government had set the course for an economic recovery of Greece which was just about beginning at the end of last year. But then the new radical Greek government set an end to the reforms and we are now in a phase, where many have no confidence any more in a recovery of Greece, and were investments in Greece by local investors and international investors are stalling.

And the latest numbers tell the brutal truth: in the fourth quarter 2014 Greece had negative growth, and also in the first quarter of 2015. This, by definition, is recession.

So, what to expect as a solution:

What is different from 2011 and from 2012, is that there is a pretty high consensus, that with a Greece leaving the Euro, there would not be a contagion, or a domino effect, which would result in other southern European countries to having to leave the Euro as well. So, a Grexit, to many, is not any more a nightmare. And it would not have to be the end of the Euro.

Secondly, many do not think, that even a complete end of the Euro, to mention the worst case, would be the total failure of Europe and the European Union, as Merkel keeps saying and warning.

Thirdly, there is open mention now, that the Euroland countries, and of course also the corporations of the real economy, have a plan B, what to do in case of a Grexit. Before, nobody dared to mention, that there is a plan B.

But inspite of all this, there is great pressure from inside the governments of the donating Euroland countries to keep Greece in the Euro and to do everything, to keep Greece away from bankruptcy. Why?

The moneys cumulatively credited to Greece are so huge, that the governments of the crediting Euroland countries do not want to stand up before their voters and having to say, that all loans made to Greece are lost, at the expense of their taxpayers, and that the losses would have been a lot smaller, had all the bailout loans of the past four years not been made, and had a Grexit been made four years ago, when it had already been recognisable, that Greece had overextended itself.

Having to admit this, is the worst nightmare of the European politicians.
And this is the negotiating power of the present Greek government.
And this makes the outcome of the present situation unpredictable.

But how long can this dealing and wheeling continue? Is muddling through really the good strategy?

Is it imaginable, that the Greek government continues to make promises to its voters, for which the taxpayers of the other European companies have to pay, and that Greece at the same time does not accept the imposed conditions for reforms in Greece, imposed by the European creditor countries?

What can also be observed and said is this:

Countries like Ireland, Portugal and Spain have also received bailout money from the other Euroland countries, and they successfully, and to a significant degree, have made the reforms requested by the creditors, as painful as these reforms have been. And all three countries by now are on the path for recovery.

If they would see, that Greece would get new money again and again, without having to carry out necessary and tolerable reforms requested by the creditor countries, they would get disincentivised to continue on their own reform path, which is not yet completed. And they would also request more bailout money, without having to pay for it by way of carrying out the requested necessary reforms. A new avalanche of bailout requests would then indeed be the end of what the giving countries can deliver.

For Spain, growth projections for this year have just been raised to 2,8 %, for Portugal raised to 1,6 %, and growth in Ireland is even booming by projected 3,6 %.

Some Euroland politicians are praising, that Eurobonds would be the solution of all problems. But: Eurobonds are not a solid financing instrument. They represent socialism of indebtedness.

Eurobonds are not the solution. It would be, like you here in this room, giving your personal credit card to somebody else, who can then freely buy for himself, herself, at your expense. What nobody in this room would do, and could do, cannot do Euroland member states either.

Let us again remind ourselves, of how the Euro is constituted in the Maastricht treaty:

-no member state should be held liable for the government debt of the other participating states, and thus there should not be any forced flow of money from one government to the other one in order to balance off government deficits. In short, Euroland should not be a Transfer Union.

-and last but not least, The European Central bank is not allowed, to finance the governments of states.

Both contractual and legal prerequisites of the Euro are by now being broken by the participating Euroland countries and the ECB, notwithstanding what is said to the contrary. And daily we must read about this great controversy, which is not going away by itself.

The view of many is: One cannot build a stable currency like the Euro, by permanently building it on the braking of the agreement, of the contract and of the law. The end of the law, if it ever occurs, would then indeed lead to the end of the European Union.

As said the German Pope Benedikt the XVI th in his famous speech in the German Bundestag parliament in 2011: Take away the law - what else then is the state than a great gang of robbers.

Saying this is not popular, I know, but it is to be said.

Still, I will not make a too pessimistic statement to you today.

Probably a point will come soon, where the willingness will collapse, to give more new money, and to get no reforms for it in Greece, and no chance for a recovery from the inefficiencies in Greece.

The Euro is not Europe. The Euro is not the European Union.

Those countries, which do not have the Euro, are also Europe.

Those countries, which do not have the Euro, are also the European Union,
9 out of the 28 European Union Countries.

The 28 European Union Countries are one of the greatest economic and political success stories in history of mankind, even without the Euro.

Since 1992, these now 28 European Union Member Countries have created this huge internal market of 507 million people without customs and tariffs.

This internal market has 4 constituents:

The free flow of Goods

The free flow of Services

The free flow of Capital, including the right to freely establish businesses

The free flow of Labour, meaning people can move freely to where they find work

This internal market is complemented by the governmental institutions of the European Union.

The European member states have given part of their sovereignty to such European Union governmental institutions, but not all.

The balance between the two is in a permanent state of flux, of discussion, and of even dispute. See the permanent criticism by the UK, saying, that too much and unnecessary responsibilities have been given to Brussels, thereby unnecessarily undermining the sovereignty of member states.

When suffering from the Euro crisis day in and day out, as is the case now, we must never forget this:

The internal market and its political framework is the biggest achievement of the European Union.

The internal market did function well from its inception in 1992 till 1999, without the

existence of the Euro, and it does function well for the 9 European Member states, which are not part of the Euro.

And it does function well between such 9 non-Euro member states with their 173 million people, and the 19 Euro member States with their 334 million people.

To preserve this 28 European Countries internal market and political framework, and the concomitant peacefully living together, is many more times important and beneficial for the people than the existence of the Euro.

Indeed, and thank God, the 28 European Countries internal market and political framework is not in danger, and it is the biggest economic and political achievement in the history of Europe.

And let me say, it is also the biggest economic and political experiment in the history of mankind. And let me add: It is admired for this in many parts of the world outside Europe.

Let me quote the Polish Donald Tusk, President of the European Union Council, who said this month:

Quote: I am profoundly convinced, that no country has a better life outside of the European Union.
Unquote.

And I do say: as Europeans we know: One of our biggest assets, among all others which are commonly mentioned, is our cultural richness and diversity. Out of this follows, that not everything must be harmonized by Brussels. To the contrary: Diversity must be maintained and cherished.

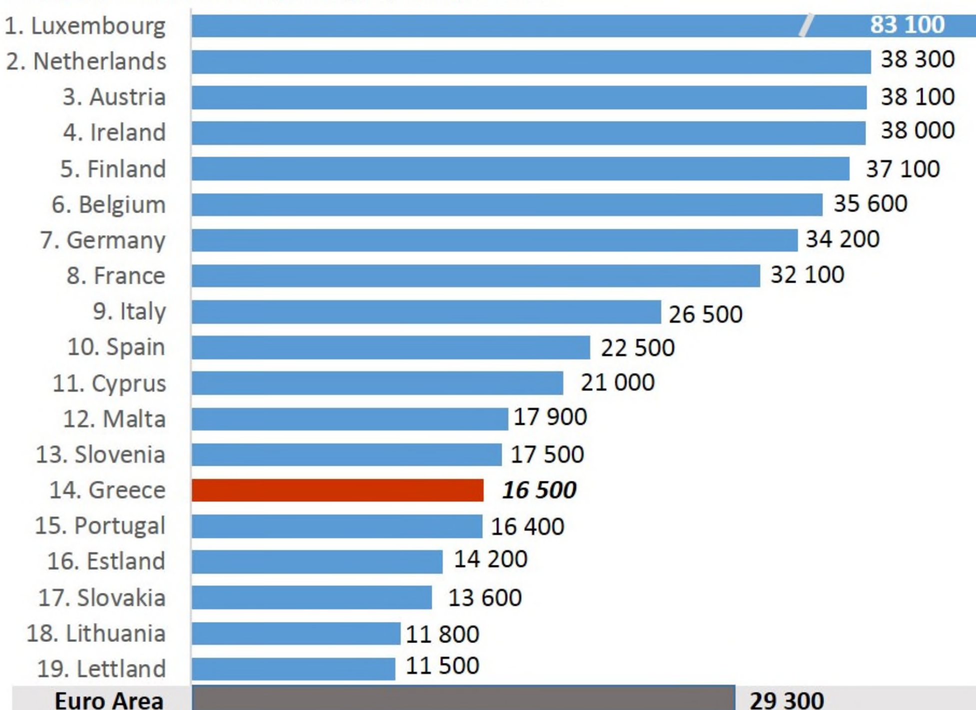
Again I quote the Polish Donald Tusk, President of the European Union Council, who said this month:

Quote:
Great Britain is playing a key role in the endeavour, to strengthen the competitiveness of Europe by way of a functioning internal market, and without an excess of regulations.
Unquote.

What advice can be given to the treasurers in this room, in the present economic and political environment:

To those in this room, not from countries, who have the Euro as currency: Do not worry not to being part of the Euro. You have the benefits of the internal market, you do not have the burdens that go with the Euro. So wait and see.

And do not forget this statistics: Within the Euro, countries with lower per capita income must subsidise countries with a higher per capita income. Why get yourself into this. Wait until the Euro has become a fair institution.



The situation is similar, when comparing the monthly minimum wages installed in selected countries:

Latvia 360 €uro
Slovakia 380 Euro
Greece 684 Euro

Says Robert Fico, Prime Minister of Slovakia: There is no reason for Slovakia, to make money gifts to others.

As to the interest rates presently prevailing: lowest interest rates in history of mankind. Even negative interest rates on government debt, never seen in history of mankind. Already some big corporates getting close to enjoying negative interest rates on their debt.

And as to the day in and day out news flow about the quantitative easing of the ECB, as to the talk of Europe falling into deflation, like the sinking ship, and as to the talk of banks not making sufficient new loans to the real economy in the Southern European States.

My advice: Do not expect, that this scenario will last for long. Negative interest rates for the broad real economy will not happen. And sustained deflation is not to happen either.
Ultra low, but still positive interest rates may be around for some more time, but also they can be over quickly.

Treasurers, whose corporations have long term financial debt, should refinance and, or renegotiate such debt, in order to make use to the maximum possible of the presently ultra-low long-term interest rates.

The corporate bond market is testimony, that capital market oriented corporations do make maximum use, now, of such ultra-low long-term interest rates. BMW, as an example, issued a 1 billion Euro 10 year bond with an interest rate coupon of 1 % only.

Another advice to the treasurers: Learn, from what the treasurers of the best of the best corporations are doing:

In Europe, and in the USA, the best of the best corporations have deleveraged, before the great financial crisis in 2008 and 2009 started, and they have deleveraged more since then. In fact, they are less leveraged and better financed, meaning more conservatively financed than at any time since World War 2nd.

In fact, it is fair to say, that during the great financial crisis 2008 and 2009, the real economy was the rock of stability in the sea of turmoil in the financial industry, and thanks to this solid real economy the entire system was not on the brink of collapse.

Complementing the solidity of financing of the real economy is this:

Many corporations have learned the lesson, that it is good to have financing reserves. And not just in the form of uncommitted or committed undrawn credit lines from banks, which may fall into trouble and which banks may not honour the credit lines commitments.

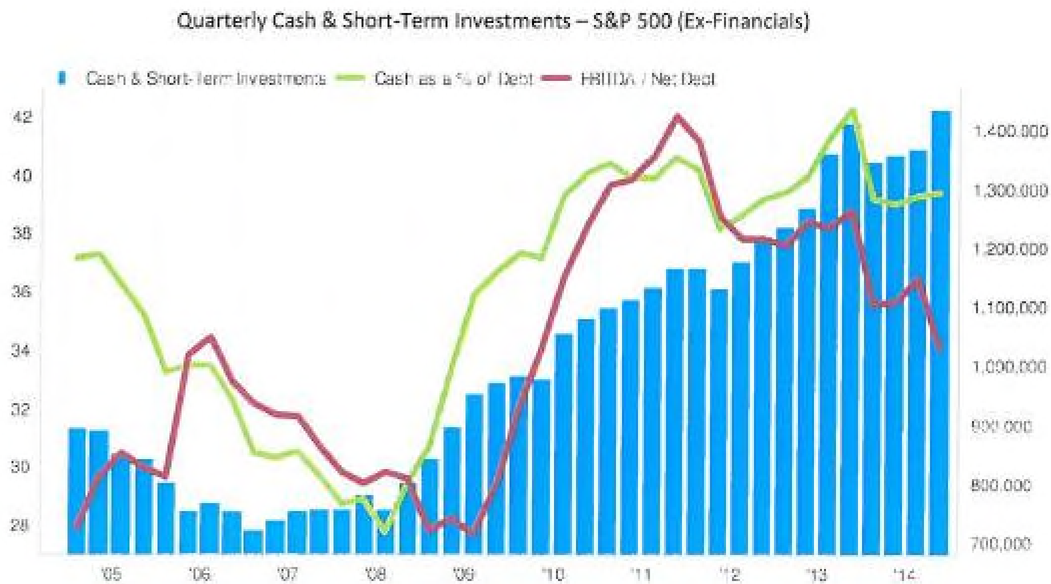
Many corporations have learned, that the best precaution against the risk of refinancing in a financial crisis situation, is to have sufficient unused cash on the shelf.

To give you an idea: The companies of the US S & P 500 index, excluding the 87 financials companies, at the end of January 2015, collectively have cash on their balance sheets of 1430 billion US Dollar, tendency rising.

With interest rates ultra low, for loans taken up, and for cash invested, the negative spread between costs of loans taken up and return on cash invested, the socalled cost of carry, is so small nowadays, that it is almost irresponsible, not to have a reasonable box of idle cash on hold as an insurance against difficult financing times.

Let me give you an example for this: The rating agencies, in order to maintain the ratings on the Daimler Group, are requesting from the Daimler Group, that it can overcome twelve months without going to the capital market and raising new funds. Daimler responded positively to this request and is now holding roundabout 18 billion Euros of cash on its balance sheet for this safety purpose, on a volume of annual group sales of 94 billion Euros. That is, they have 20 % of annual turnover as cash, for safety purposes.

See this chart.



Cash & Investments Quarterly is one part of three reports (Buyback Quarterly and Dividend Quarterly) analyzing cash and discretionary spending within US large-cap companies. The other reports can be found at http://www.factset.com/insight or within the FactSet Market News application of your FactSet workstation. All data published in this report is available on FactSet. Please contact media_request@factset.com or 1-877-FACTSET for more information.

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Another example: The Audi Group, another premium car producer, has 16 billion Euros net cash, on a volume of annual group sales of 54 billion Euros.
That is, they have even 30 % of annual turnover as cash, for safety purposes.

A recent survey by Deloitte, among 150 German CFOs of major German corporations, shows this conclusion: Financing conditions are at their best in history, meaning the ultralow interest rates, and credit availability is at a maximum. Ladies and Gentlemen, how much better than this can life be for us, the treasurers.

Ladies and Gentlemen, on another note:

I have not yet addressed the subject of over-indebtedness of states and governments which is particularly worrying to many people and in many member countries of the European Union.

Two numbers demonstrate the phenomenon: In 2008, shortly before the financial crisis, the government indebtedness of the 19 member states of Euroland was at 69 % of GDP. At the end of 2014 this number had increased to 92 %.

The strong increase is mainly due to governments bailing out banks from the huge losses of the financial crisis, but it is also due to general deficit spending by governments for general and all kinds of political purposes.

Ever since the financial crisis in 2008 and 2009, there is an ongoing worldwide debate on the question which government indebtedness is acceptable and which government indebtedness is not acceptable and tolerable for the longer run. The keyword in this connection is the notion of debt sustainability of a state meaning how much that state can bear and service over time, without getting to the brink of insolvency.

We – as treasurers in our corporations – have a pretty clear view what the debt sustainability of our corporation is. And we are not left alone asking ourselves when / what such debt sustainability of our corporation is. If we have doubts about what it really is, then we will talk to the banks which make loans to us. That will help us quickly to learn where our debt limits are.

And if we do not believe what banks are saying and if we want to issue debt securities in the capital market, then we will always be able to go to the rating agencies, and they also will clearly tell us what our debt sustainability is, and by which margin it may vary to the upside and downside. Further than that, the rating agencies will clearly tell us at which indebtedness ratio our rating would be AAA, and at which indebtedness ratio our rating would be subinvestment grade, meaning below BBB-.

And of course – as we all know – the acceptable debt ratio is not only this static number. It has to be complemented by the EBITDA earnings to fixed financial charges ratio.

And the laws in our countries also tell us, when we have overextended the corporate debt and have to declare insolvency. The two alternative reasons for insolvency, given in the law are:

-One, so called over-indebtedness, meaning a corporation has more debts than assets.

-and Two, illiquidity.

Even if the corporation is not over-indebted, there may be the possibility that it may become illiquid. This will happen when a company has depleted all its available cash and when – at the same time – nobody is willing to credit new money to the corporation.

Why do I speak out this, what is known to all of you?

I speak it out, because when it comes to government and state financing, there are no such guidelines / regulations / laws.

There is no regulation and law in the world which regulates the situation, when a country or a government is bankrupt and which procedures will then have to be taken.

With countries like Greece, presently on the brink of financial collapse, there is the desire in the European Union by many member countries, since a long time, that it would be wishful to have regulations that clearly define what a bankruptcy of a state government is, and which would give clear rules and guidelines, as to how to proceed in such a case.

There are also requests by many politicians at the European level, that such regulations should be put in place. But as no individual country has such regulations for its own country and government, it is so much more difficult, to establish such regulations within an association of states like the European Union.

So, clear rules for state government bankruptcies, remain wishful thinking.

What guidance do we all have when we have to make an opinion about whether a country, a state and a government have a debt level which is sustainable over a longer term or not.

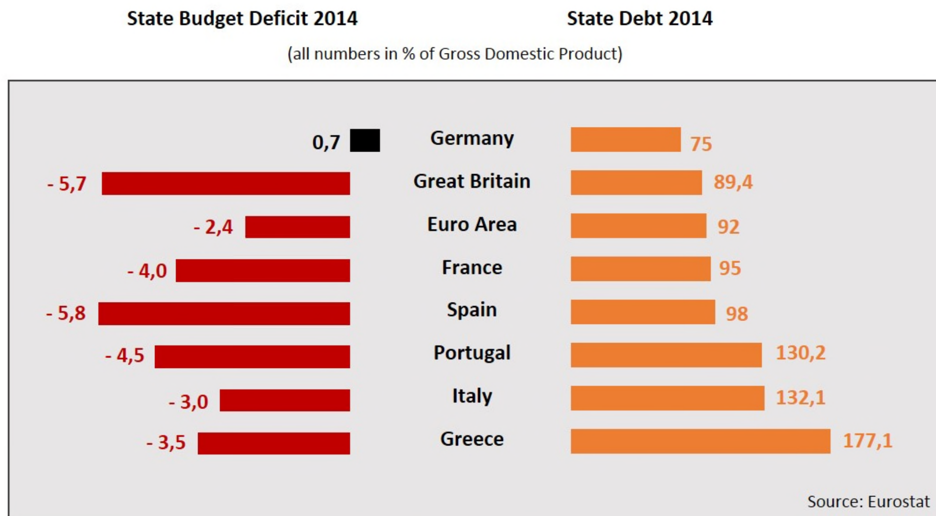
Here are some answers:

According to the Maastricht Treaty criteria a government debt level of 60 % of GDP is acceptable.

In the past few years much research and studies have been done by economic professors worldwide and there is a conclusion of all this research that a government indebtedness in the order of 100 % of GDP is just about tolerable though not desirable over the longer term. Any ratio in excess of 100 % is said to make the economic and financial situation problematical for a government and a country, and it will endanger the possibility for the country to further grow its economy.

Let us have a look at the government debt ratio of a few member countries of Euroland:

Greece has presently a government debt ratio of 177 % of GDP which – due to the orientation ratios which I have just mentioned – appears as not manageable over a longer term.
Italy with 132 % and Portugal with 130 % are already both in a problematic range.
France with 95 % is approaching the 100 % ratio which is regarded by many as just about tolerable.
Germany with 75 % is less indebted, but it is over and above the Maastricht criteria of 60 %, which, however, the German acting politicians want to reach again over the medium term and they are striving for it.
At the low end, you find Estonia with only 11 %. The low ratio is partly due to the fact that after the fall of the iron curtain, countries like Estonia made a new start.



We have a similar to Europe situation in the United States of America, where the government debt ratio is presently 110 % of GDP. And we have the most extreme situation in Japan, where for country-specific reasons the government indebtedness is at around 250 % of GDP.

You see also on this chart the annual 2014 government budget deficit in % of GDP, and with the exception of Germany, they all on this chart are above the Maastricht criterion of an annual government budget deficit of 3 % of GDP.

However, this chart does not show all 19 member countries of the Euro.
The good news is, that out of the 19 member countries of the Euro, still 7 countries in 2014 are meeting this budget deficit criterion and are below the 3 % ratio.

And as you see from this chart, the annual budget deficit of all 19 Euro Area Countries is at minus 2.4 % in 2014, down from the minus 2.9 % of 2013. So there is some improvement.

There is a kind of consensus among many representatives of the Western World countries, that from here on the government indebtedness should not be increased further.

What acts as a brake against a further significant increase of government indebtedness, is the fact, that with such an excessive indebtedness goes an interest expense burden, which takes an ever increasing bite out of the government budgets and which leaves such budgets with a sinking portion of their government tax and other available income available for all typical other political purposes.

Raising taxes further to higher levels is not a remedy to this situation, because in many of such countries, the existing tax level is already considered as a very high, if not too high burden for the people, and to the degree that there is even disincentive to people for doing business and paying taxes.

In the European countries and in the USA, there is wide spread opinion, that given the present debt levels of countries and governments, that such governments should not stimulate their economies, which are in recession, with huge deficit spending programs.

Many say that you cannot buy economic growth anymore by governments executing huge deficit spending programs. This would only increase the government indebtedness and would drive governments further into financial difficulty and immobility. As the governments have run out of tools to stimulate their economies, what is left? Well, we all see it:

In the USA at first, also in the United Kingdom, and in Japan, and now also in Euroland, the same is happening everywhere: The Central Banks are trying to help out and to stimulate the economies, with the limited tools they have: the buzzword is "quantitative easing".

The result of this is, that the countries are flooded with money and as an intended consequence, the interest rates have fallen to the ultra-low levels, which mankind has never seen before. The question for many people is: Does the system get out of control and balance?

The critique against this worldwide quantitative easing and ultra-low interest rates is brief and simple:

1. Interest rates being ultra-low are losing their function to allocate the scarce capital in the economies to the points of highest return and efficiencies. The compass for economics and profitability is being lost. Investments are increasingly flowing into higher risky asset classes and new asset bubbles may arise which will burst sooner or later. So new financial crises will be created.

2. The main beneficiaries of the ultra-low interest rates are the governments, indeed, by making their interest expense burden lower than it would be with normal interest rates levels.

3. There are also many losers due to these ultra-low interest rates:

   These are all the savers, in fact the broad mass of people and individuals, who are saving money, many of them with the purpose of having some financial reserves for the case that retirement pensions will not be sufficient.

   Losers are also insurance companies, pension companies, pension funds, the business of which is, to increase over time the capital, they received as premiums from the insured, so that in future they can pay the pensions, which they have contracted with the insured people, and they build this capital by investing predominantly into bond securities, which now carry almost no interest any more.

This phenomenon, that the savers and the pension insurance industry are losers, due to the quantitative easing, has a name: It is called "financial repression". It is described with clarity by economists and economic professors. And it is not a new phenomenon.

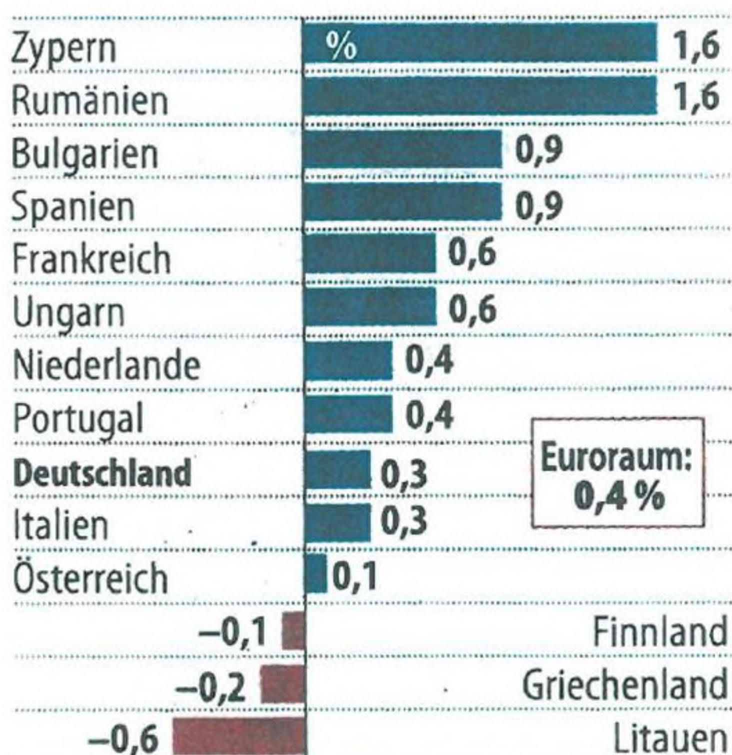
After the second world war, the then over-indebted United States used the instrument of financial repression to get itself out of the government over-indebtedness over a period of almost 20 years. Interest rates in this period were often lower than the inflation rate for a long time. Both, continued inflation, and good annual growth rates of GDP, then continuously decreased the relative indebtedness of the USA.

Ladies and Gentlemen, the day-in/day-out question to everybody is, how long will this financial repression last? There is no consensus opinion on it. Since a few years, financial repression is already existing – and it may last longer, than just a couple of more years.

In summary: ultra-low interest rates,
financial repression,
and incentives to investors to move into riskier asset classes

all this is not a good situation, for the economy as a whole, to prevail for long, but let us hope and work for a better world !

At least, and to close with some optimism,



Growth is again returning to a number of Euro Area Countries, and here on this chart you have a selection of such countries. This makes us hope for an improved business cycle. Thank you very much.

Germany, Interview: Equipping Bayer MaterialScience for the future

Interview with Bayer CFO **Johannes Dietsch**, from Börsen-Zeitung, Frankfurt am Main, Germany, March 21, 2015. Article provided by The German IAFEI Member Institute, the Association of Chief Financial Officers Germany

Bayer CFO: Intra-Group loans are to be promptly replaced following demerger – IPO could have a positive effect on Group rating

Bayer has taken an important strategic step with its decision to demerge the plastics business. How can a subgroup be separated from the Group for financing purposes?

Bayer Material Science (BMS) is to be floated on the stock market by mid-2016 at the latest. We want to create an independent company that is able to tap the capital market. With regard to financing, we first have to give BMS a sound organizational structure. It needs to have a

financial department that can communicate with the capital market and the banks. The employees who will look after the finances of BMS in the future have been selected. The job of these professionals from Bayer's finance department and from outside the company – led by the new CFO, Frank Lutz – is to put intra-Group and external financing in place. Prior to the separation, we will grant BMS intra-Group loans that will be replaced by external financing once that company is legally independent.

Can you comment on the size of these loans?

No. We still have more ground to cover before we can determine the new company's asset and liability structure. We are very flexible in this regard.

Is there a blueprint for this procedure?

The blueprint is Lanxess – we followed the same procedure there. To pay back the loans, the new company will have to tap the banking or capital markets. Of course, we won't leave this until after the stock market flotation. We are already in talks with banks interested in acting as relationship banks for BMS. Together with BMS, structures such as syndicated credit facilities, bank loans or the like will be established to replace the intra-Group loans. At Lanxess this happened immediately, directly after the stock market flotation. However, Lanxess was a 100% spin-off. We also have the flexibility to replace the loans over a longer period. But BMS will be ambitious enough to quickly establish itself on the capital market.

What will BMS's equity and debt situation be at the start? At Lanxess, the focus was on achieving an investment-grade rating.

The new company will have to be able to secure external financing to replace the intra-Group loans – either through the banking market or the capital market – preferably the latter. A rating assessment is useful for raising capital in the market. We aim to give BMS an asset and liability structure that enables it to issue bonds.

But that isn't the same as an investment-grade rating.

We haven't made a decision on that yet. As I said, we will determine the exact capital structure at a later date.

Do you have an idea of what the equity ratio could be at the start?

No, we haven't reached that stage yet. We have now completed the design phase. It was very important to us to first clearly define which sites and companies and how many employees will be transferred to BMS. We are now busy preparing pro forma financial statements for the past three years. These are the combined financial statements, which we need for the securities prospectus for either an IPO or a spin-off. Equity and liabilities will be balanced out based on these combined financial statements – ultimately it's just a question of finding the right ratio between equity and debt.

Why is that process so complex? You already have a demarcated business thanks to Bayer's organizational structure with the three subgroups under the umbrella of a holding company.

It is correct that we have subgroup companies in Germany and certain other important countries, such as China, the United States and Belgium. In some other countries, however, the business units form part of a local Bayer holding company. In many countries, we intentionally didn't create separate subgroups so as to leverage synergies – partly for tax reasons. We also only have one department in the country companies for administrative functions such as human resources or finance. These activities now have to be separated. Another example: many employees in Germany will transfer from

our subsidiaries Bayer Technology Services and Bayer Business Services to BMS. This will have an impact on headcount, the financial position and the organizational structures.

Where subgroups were merged outside Germany for tax reasons, will the corresponding demergers lead to tax expenses?

The creation of a legally independent company will often require the transfer or sale of subsidiaries abroad from the respective local Bayer holding companies to BMS AG. This must be handled like a sale to a third party, and that generally results in tax expense. We of course aim to keep the resulting charges as low as possible.

What impact will the separation of MaterialScience have on the rest of the Bayer Group?

One of the reasons we decided to demerge BMS is that the relative importance of MaterialScience within the Bayer Group has declined. Some 90% of EBIT is now attributable to the Life Science businesses. This is a tremendous opportunity for BMS, as the subgroup would have found it more and more difficult to obtain the necessary resources as a result of internal competition with the higher-earning Life Science businesses. So there won't be much of an impact on the rest of the company. Our Life Science businesses are already very successful – just think of the very gratifying development of our recently launched products. Of course, we are nonetheless looking at areas where we can become more efficient.

Bayer Share Price versus DA

As of June 25, 2015
Bayer share price 133,55 €, p/e ra   ɘturn 1,96 %

All of your debt instruments now have change-of-control clauses. Is this now standard, and do you feel it will protect you against a hostile takeover?

This trend has been in place for some time now and serves to protect investors. The aim is to give investors the opportunity to redeem bonds in the event of a change within the company. It is not primarily intended as protection for the company. The best defense against an unwanted takeover is clearly a high share price.

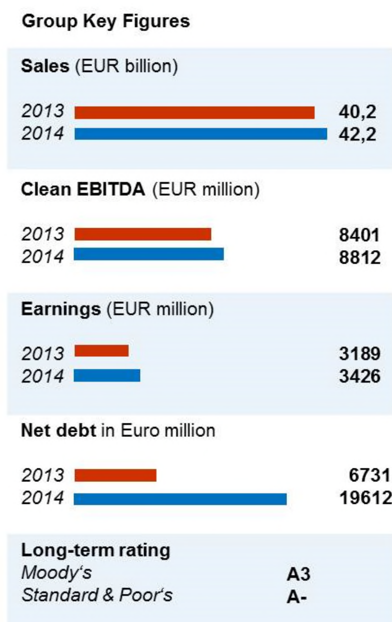
There will be substantial changes in the statement of financial position, however. After all, a major proportion of non-current assets will go to BMS. What assets will remain with Bayer?

We have a very high level of intangible assets. With regard to equity and liabilities, we intend things to remain the way they are today. When I talk to investors or rating analysts, they mainly look at future cash flows, or the ratio of cash flows to debt – the latter being the main factor.

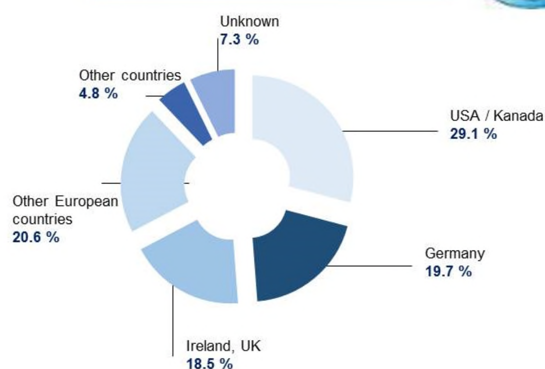
The Bayer Group's risk profile will also change as a result of the carve-out. Will the company's rating come under pressure?

We of course discussed this issue in advance with the rating agencies. They regard the planned stock market flotation of BMS as neutral to our rating. An IPO could even have a positive effect on the rating because it would strengthen our equity.

Bayer at a glance



Stockholder structure



Market capitalization
Status June 19, 2015
EUR 106 billion

Source: Corporation, Thomson Reuters

It was clear last year that a high market capitalization doesn't necessarily offer protection. Is Bayer increasing the risk of a hostile takeover by floating BMS on the stock market?

We don't feel this is the case, and it's not an issue for us at all at the moment. As long as we successfully manage our businesses, a very high premium would be payable to take over our company. These premiums could be justified either by high synergies or tax benefits. However, the latter are no longer so easy to obtain.

The strong U.S. dollar gives interested parties in the United States a significant boost with regard to potential acquisitions in the eurozone. Won't you have to keep this aspect in mind?

Certainly it makes a euro acquisition more attractive from a U.S. dollar perspective. That cannot be the only criterion, however. In my opinion, the deciding factor continues to be whether a company is in good shape and is well managed.

Does Bayer still have the flexibility for further acquisitions in view of your record net debt of nearly EUR 20 billion?

We had a similar level of debt following our acquisition of Schering. Back then, however, we had lower debt sustainability than today. To that extent it's not a completely new situation for us. Following the acquisitions of both Aventis CropScience and Schering, we reduced our debt again quite rapidly. That is one reason why the rating agencies haven't downgraded us this time even though we temporarily aren't meeting the rating requirements.

Would you say your headroom is restricted?

If strategic opportunities were to present themselves, a transaction certainly wouldn't fail for lack of financing. However, debt reduction is our clear priority at the moment.

What internal target have you set for the gearing ratio?

We look at the rating indicators very closely, because they are crucial for us. Specifically, funds from operations would have to amount to at least 35% of total net debt to get an A- rating from Standard & Poor's. We are currently slightly below that. The situation with Moody's is similar.

Is there a definite timeline for the reduction of debt? Have you set a target?

The target ratio is 35% cash flow to debt. This means the more EBITDA we generate, the greater our debt capacity. In other words, we work on both the numerator and the denominator.

How have the conditions for debt financing changed over time? What interest rate would you have to pay today for a term of ten years?

We concluded the major financing measures for the OTC acquisition at an average of 2.6%. This includes the hybrid bonds, which feature coupons of more than 3%. If we were to issue a ten-year bond today, we would probably have financing costs of 1% – if we stay in euros.

Why did you issue an enormous volume in dollars last year if you can finance at a lower cost in euros?

Because we had to pay the purchase price in dollars. We also hold assets in U.S. dollars and achieve long-term cash flows in that currency. This means we also achieve natural hedging. That's why it was a good opportunity to go into the U.S. market. We issued bonds according to Rule 144 A for the first time since 1998. It was new ground for us that we broke very successfully.

Do you have the opportunity to convert the dollar bonds into euro securities because you have lower interest costs here?

We generally finance in the currency in which we make the investment. What's important is currency-matching, which means having enough dollars on hand to meet dollar obligations or swapping euro amounts into dollars. All of our financial transactions are currency-hedged – we do not engage in currency speculation. Overall we have structured the profile of our primary maturities so that about EUR 1.5 billion to EUR 2 billion can be paid back each year. That will roughly correspond to the amount of free cash flow available to service our debt.

Acquisitions added more than EUR 13 billion in goodwill and intangible assets to Bayer's statement of financial position last year. Was the price too high?

The purchase price is derived from the present value and future cash flows. In other words, we include the expected synergies in the calculation, albeit not in full. Our calculation here is sufficiently conservative that we also generate value for Bayer's stockholders. What's more, we discounted at the average cost of capital of 8% and not at the financing rate of 2.6%. The business will therefore generate value very quickly, because a value contribution will also come from the financing.

Nonetheless, experience shows that acquisitions worth billions also harbor a high risk of impairments. How do you assess this risk with regard to the Merck acquisition?

That's a question of the purchase price allocation. The fact is that we account for a major proportion as intangible assets that are amortized over time. Goodwill, however, is not amortized. I personally was very comfortable with the previous rule under which goodwill was also amortized. Today, by contrast, goodwill remains on the books forever and has to be regularly subjected to impairment testing. As long as the businesses develop within budget, impairments should not be an issue.

You amortize intangible assets in full. What periods do you use for trademark rights?

The amortization period depends on how long these assets are utilized. In the case of Consumer Care – in other words the business with non-prescription medicines – we have applied very long terms of up to 35 years. This is based on our experience. For example, a brand like Aspirin is 115 years old, and Bepanthen is 70 years old. These brands continue to grow to this day. One could almost say that such brands shouldn't be amortized at all. The situation of course is different for pharmaceutical products because of the patent terms.

" Goodwill remains on the books forever and has to be subjected to impairment testing. As long as the businesses develop within budget, impairments should not be an issue."

The price of oil has dropped sharply. At Bayer, is this only relevant for BMS? How is it affecting the subgroup's competitiveness?

It is primarily the petrochemical derivatives that are significant to us as Bayer, and these of course have also become less expensive in parallel with the price of oil. BMS has to be able to pass these price declines onto the market with a certain time lag, and not in full.

This is likely to be relatively difficult in view of the current supply and demand situation.

That's just it. It depends not so much on the price of raw materials – but rather on the supply and demand situation, which varies starkly by region: while there is strong demand in North America, the weakness of the European economy is leading to an oversupply, and the markets in Asia are volatile. The individual product groups are also developing in different ways. At Polycarbonates, for example, we are currently seeing a slight scarcity of supply, while there is an oversupply for some other products.

In China especially, there are now tremendous overcapacities in certain markets. Has this affected Bayer?

China is a special case. It was important to us to make local capital expenditures to demonstrate our technology leadership and also to gain cost leadership – particularly as regards energy costs. We want to operate so efficiently that our competitors have to adjust their capacities. In some cases this currently isn't happening in China because numerous smaller competitors play an important role in their local provinces and even maintain production when it no longer makes business sense to do so. That's why certain polyurethanes aren't so successful for us at the moment in China. But in the long term, demand should increase here as well and the volumes will be absorbed by the market.

This interview was conducted by **Claus Döring** and **Annette Becker**.

About Johannes Dietsch

A fan of Asia

Johannes Dietsch can't and doesn't deny that he's a Rhinelander. Bayer's CFO since October 2014 comes across as charming, open and pleasant to his guests. Indeed, the return of the 53-year old to Germany last fall was somewhat surprising – Dietsch had just moved to Shanghai three years previously to be the Senior Bayer Representative for Greater China. But who can say no to the position of CFO at Germany's most valuable company?

Particularly as it's the start of such an exciting time in finance at Bayer following the pharmaceutical and chemical company's decision last year to transform its structure. This will involve the demerger of the plastics business – the MaterialScience subgroup – a task that Dietsch is virtually predestined for given that he already headed the Lanxess spin-off in 2004-2005. At the time, Dietsch was the Head of Finance, which in the Bayer world is often the stepping stone to becoming CFO.

Dietsch can look back on a classic Bayer career. After finishing school and then completing training with Bayer as a commercial assistant and business administrator, he held positions in various departments before spending several years in Japan in the mid-1980s. During his second posting to the Land of the Rising Sun at the beginning of the 1990s, Dietsch didn't want to believe his eyes. The once booming country had fallen into a major depression. But even after having returned to Leverkusen for eleven years, Dietsch still had the travel bug. In 2011 he made his way back to Asia once again, this time to China.

Source: Börsen-Zeitung, Frankfurt am Main, Germany, March 21, 2015. Responsible for Translation: Bayer AG

Germany, Article: Contingent Convertible Bonds – a Market with Future

By **Melanie Kiene,** analyst fixed-income-research, Nord/LB Bank, Hannover, Germany, from Börsen-Zeitung, Frankfurt am Main, Germany, June 6, 2015

Contingent Convertible Bonds (Coco-Bonds) are enjoying increasing popularity since a few years. The outstanding volume of Coco-Bond-issues in Europe at the end of May 2015 amounts to roundabout 126 billion Euro. These capital market instruments, issued mostly by banks, are not new. However, they can be used by credit institutions in order to reinforce their regulatory equity capital, without having to make an expensive rights issue. The more so, as the issuance of Coco-Bonds does increase the loss absorption capability, and a bank thereby becomes more resilient in crises, and this protects the taxpayer from being asked to eventually bail out such bank.

Defining the Trigger Event

There are three overall kinds of Coco-Bonds: conversion into shares/equity, as well as partial respectively complete or transitory depreciation. For the recognition as equity, either as additional core capital or as supplementary capital, there are certain minimum characteristics in the capital requirement regulation (CCR). Among others, the trigger-event is being defined. Should the hard-core capital ratio fall below 5,125 % or another number defined by contract by the bank of over 5,125 %, then the trigger-event is happening. This can for example be the conversion of the bond into equity, or the depreciation. It can also be the case, that a bond issue does not only have a trigger on the level of the issuing company, but also at the same time a trigger at the level of the company group.

For this reason, and since the CCR is mandatory, almost only Coco-Bonds with a trigger of at least 5,125 % are issued. The outstanding volume of such types of Coco-Bonds, to which hereafter this article relates if not otherwise stated, amounts to almost 100 billion Euro. So far in 2015 a bit more than 20 billion Euro have been issued, mostly AT1-capital, in the previous year in the same period more than 23 billion Euro have been issued. For the total year of 2014 the issuing volume amounted to 50 billion Euro, and was thus by almost 35 billion Euro above the level of 2013.

Even though the issuing activity has somewhat slowed down not only versus 2014, but also since the beginning of 2015, which was caused by the recently increased risk aversion, there is to be expected that in the second half of 2015 more primary issues are going to be offered. Here, we do assume that there will increasingly be issues of the type of complementary equity capital or other debt instruments with bail-in characteristics. This is being caused by the fact that the credit institutions have to fulfil their regulatory requirements as regards their equity capital, as well as further requirements (TLAC, Total Loss Absorbing Capacity, respectively MREL, Minimum Requirement for Eligible Liabilities).

Although presently we are still in the introducing phase of Basel III, with complete application starting 2019, we still see that here the systemically relevant banks must already now prepare for a higher quality of their equity because of the stress tests which are being made regularly. This could be seen, especially in 2014, through an increased issuing volume in the context of the ongoing UK-stress tests and the comprehensive assessment of the European Central Bank and the European Banking Association, EBA.

The primary market issuing volume is also increasingly determined by the successive non-recognition of old outstanding mandatory convertible bonds. For such bonds, which are not meeting the minimum criteria of the CRR, there is a phase-out until 2021 whereby Coco new issuances will partly be made for the reason of replacing such phase-out bonds.

Among the most active countries in this year 2015 is **Great-Britain** with the volume of new issuances of roundabout 6 billion Euro counter value. Already in the past year, the British have been leading the issuing ranks with 15,7 billion Euro counter value in the European primary market for Coco-Bonds. Departing from the minimum CET1-trigger of 5,125 % in the CRR, the British regulator recognizes Coco-Bonds as AT1-capital only, when the threshold is at least 7 %. Especially Lloyds has issued a large part of Coco-Bonds replacements.

Stricter equity capital regulations, than proposed by Basel III, has also the **Swiss** financial market supervisor **FINMA**, for the large banks Credit Suisse and UBS. The minimum-CET1-

ratio is for both these global systemically important banks at 10 % and the minimum-T1-ratio at 19 %. For the re-composition of the AT1-capital, the banks (G-SIB) can issue Cocos. However, the FINMA distinguishes these instruments between low-trigger-Cocos, which are triggered at 5 % in case of liquidation, and high-trigger-Cocos, which are executed with a trigger at 7 % during the current business operations. The low-trigger-Cocos on the Basel III are recognized as Tier-2-capital. In total, the Suisse banks have already issued 14 billion Euro of Coco-Bonds. Of this, the great majority was done by the two large systemically important banks in Switzerland. With one exception, the bonds have been issued exclusively in US-dollar. The more national orientated smaller Swiss banks, which are gathering their investors predominantly in the home market, chose as issuing currency the Swiss franc.

Outside Europe, especially the **Chinese banks** are having a large share of the Coco-Bond market with a counter value of 14 billion Euro.

Issues by **US-entities** are not to be expected, which is caused by the accounting regulations of the US-GAAP. So the traditionally issued non-cumulative perpetual preferred stocks of the US-banks are regarded as equity under the US-GAAP and are thus, from the regularity point of view, in conformity with AT1-capital.

After the federal ministry of finance of **Germany** has granted the tax-wise deduction of interest expense, in Germany the Deutsche Bank showed up as the first Coco-Bond issuer. Presently, the outstanding of Coco-Bonds in Germany amounts to 5 billion Euro and relates, d apart from the number one German bank, only to one other bank, the Aareal Bank, with 300 million Euro. However, the Deutsche Bank has made a trigger event for its issue at 5,125 % whereas the Aareal Bank has a trigger of 7 %.

The issuance of Coco-Bonds is advantages for banks also for other reasons. Among these are for example the increased pressure on the capitalization to be equipped with sufficient loss-absorbing means as by the requirements of the financial stability board in relation to the holding of sufficient loss absorbing means (TLAC, Total Loss Absorbing Capacity) and the minimum requirements as to the amount of equity and the minimum requirements as to the amount of bail-in capital liabilities (MREL, Minimum Requirement for Eligible Liabilities) of EBA.

Whereas the TLAC-requirements only apply for global systemically important banks (G-SIB), the technical standard MREL relates to all banks in the European Union. As well for TLAC, as well as for MREL, there do not yet exist final regulations.

AT1-Coco-Bonds can be included in the calculation of the Leverage Ratio. As a matter of principle, a higher equity position is protecting the investors in senior bonds, which implies a build-up of bail-in buffers. However, for this purpose, banking institutions will issue predominantly Tier2-bonds, which by comparison to CET1- or AT1-equity are more favourable.

Coco-Bonds embody much higher risks for the investor (partial loss or total loss, restrictions on interest payments, no obligation for compensating for non-payments during certain periods), than is the case at a senior unsecured bond. Why then do these high risk securities meet such a high demand? The more so, as Coco-Bonds are not “Plain-Vanilla-Products”, and as the small print has to be scrutinised diligently.

Search for Return

The greatest factor of incentives, which makes this asset category so attractive in the search for return, is the present low-interest rate framework. Coco-Bands are offering interesting chances of return, and are offering a return pick up versus subordinated bond. As an example be mentioned here a Coco (DB 6 05/31/49) of the Deutsche Bank, by comparison to two subordinated bonds (DB 2 ¾ 02/17/25, and DB 5 06/24/20). Per May 28 the yield to maturity of the Coco-Bond was at 5,353 %, and the yield to maturity of the subordinated bonds at 2.849 % and 1,662 %.

Whether or not a Coco bonds, as per the covenants and characteristics, is to be evaluated as speculative and risky, can only be found in the small print. Because of which the evaluation of such bond is difficult and complex. In addition, a comparison is difficult to make, due to multitude of details.

Coco-investors should therefore check the issuing institution diligently in a careful way as to the chances and risks, before they enter into an investment.

from Börsen-Zeitung, Frankfurt am Main, Germany, June 6, 2015, Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

India, Article: Modi – Nomics: The Optimistic Case for the World´s Third Largest Economy

By **Payden & Rygel,** Los Angeles, California, USA, Spring 2015,
Point of View, Our Perspective on Issues Affecting Global Financial Markets

Narendra Modi, the son of a tea merchant, has quickly become one of the world's most talked-about leaders. But does he bring real change or is his election just another fanciful Bollywood love story for the 1.2 billion Indians living in the world's third largest economy?

Nearing the end of his first year in office, Modi has cut bureaucratic inefficiency, made steps toward putting India's fiscal house in order, and advanced India's quest to become the next manufacturing hub of the world. While many of the benefits may arrive years down the road, we are optimistic that the reform momentum Modi personifies will thrust India forward and boost the country's economic growth prospects.

The Personification of Hope

Modi swept to victory with an election campaign analogous to American President Barack Obama's in 2008. Modi used Twitter hashtags, 3D hologram appearances and catchy slogans to create the "Modi Wave," which swept the nation. Modi's calls for economic growth through "minimum government and maximum governance" resonated with young Indian voters.

Modi himself embodies the "Indian Dream." He rose to fame during his ten years as the Chief Minister (Governor) of Gujarat, the fourth largest Indian state (India has 29 states) by gross domestic product (GDP). During his tenure he provided 24-hour electricity access–a rarity in India that made the state a darling for industrialists. As a result, Gujarat grew 10% per year between 2004 and 2012, well above the Indian average of 8.25%.1

Can he replicate his success in Gujarat for the rest of people of India?

Moving the Bureaucratic Behemoth

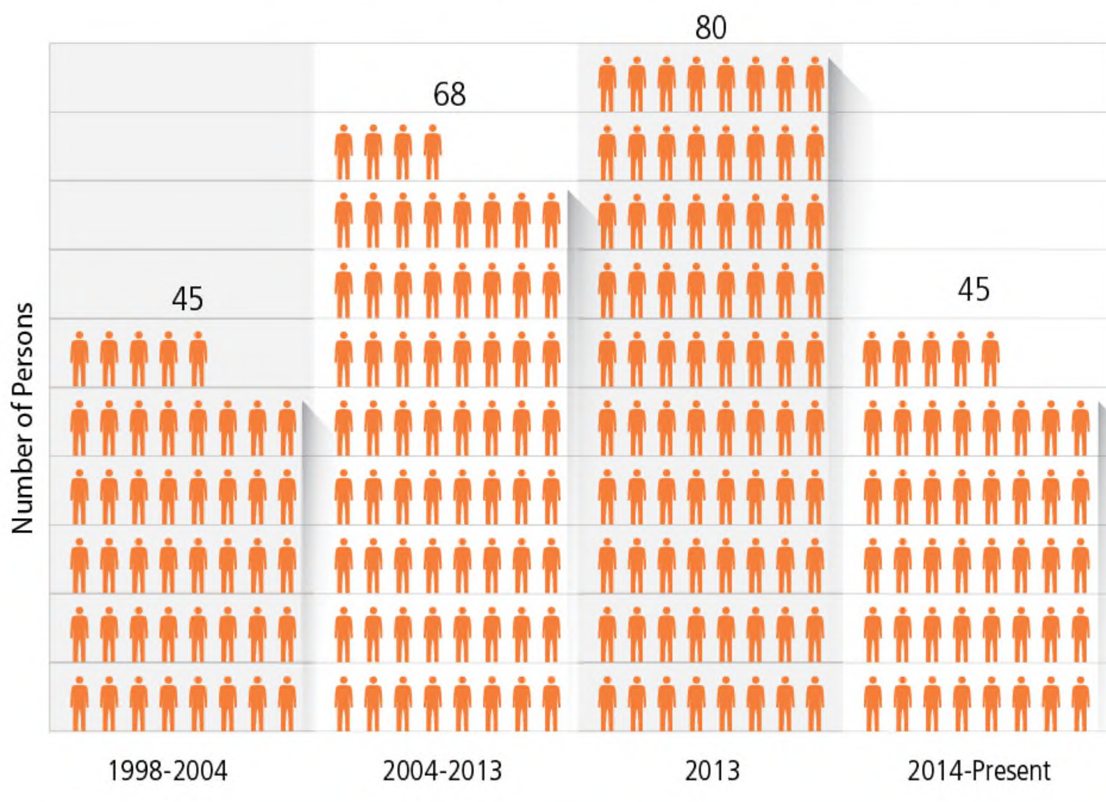
For decades India has been plagued by politicians who made election promises to rein in bureaucracy and increase efficiency but failed to deliver.

Using his political capital and reputation of "CEO-style" leadership from his days in Gujarat, Modi quickly inspired India's notoriously inefficient bureaucrats to

work. As old files were thrown out and offices were cleaned, some agencies found files dating as far back as the time of British colonial rule.

Modi personally called ministers on their desk phones to ensure they were at work on time, and instituted a biometric "check in, check out" system for government employees that can be accessed by anyone in real time. The system has led to a morning rush of government employees at the Delhi Metro in a scramble to arrive at work on time.2

Modi also abolished around 30 committees that had been set up by the previous government to resolve disputes between ministries, a symbol of policy paralysis.3 Instead, his office and cabinet, the smallest in 16 years (see Figure 1), will resolve disputes directly and leave decision-making to the ministries themselves, without the burden of overarching groups and panels. These small, but meaningful steps in the central government were only given lip service by politicians until now.

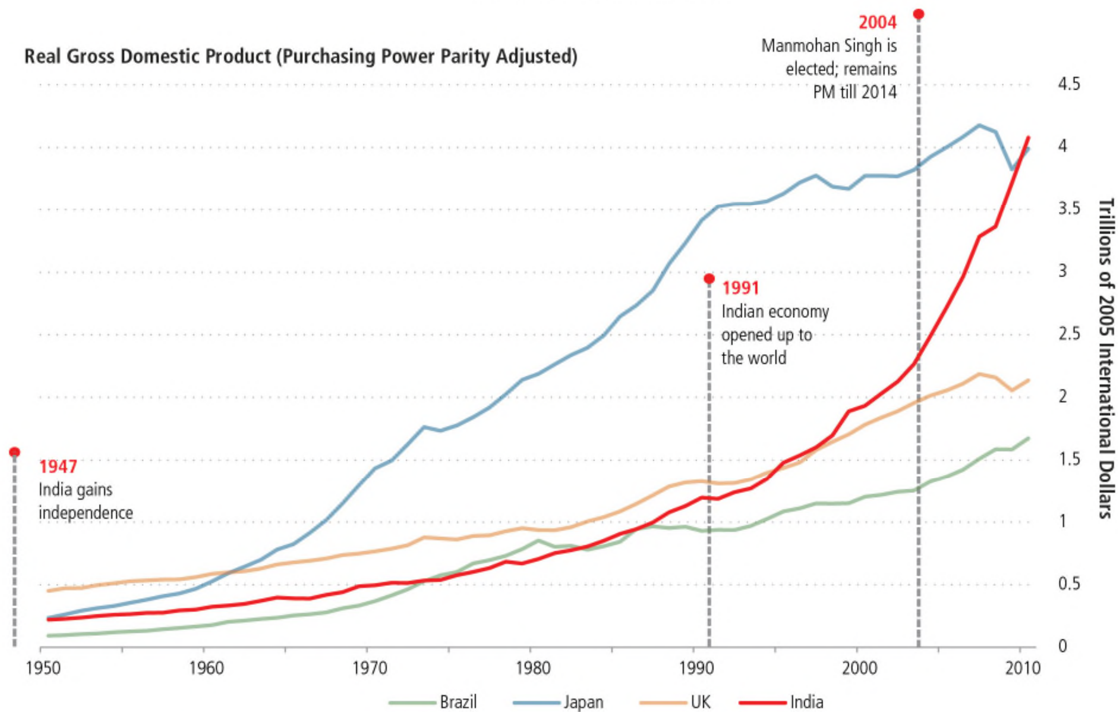


"Come…Make In India!"

In 1990, the average Indian citizen had slightly more income than the average Chinese citizen, as measured by GDP per capita. Today, China's GDP per capita is more than double that of India's. Manufacturing and export-led growth, which also made countries like Japan and South Korea prosperous, drove China's economic miracle. Instead of reinventing the wheel, Modi has gone back to basics.

Modi's economic reforms aim to make India the manufacturing hub of the world. However, half of Indian workers are still employed in low-paying agricultural jobs, and Modi knows that manufacturing jobs offer higher wages. A worker in manufacturing is 14 times more productive than one in agriculture, and higher productivity brings higher wages.4 In order to bring these jobs to his nation, Modi aims to reform land and labor laws and increase inflow of capital via foreign direct investment to serve as the catalyst for his "Make in India" campaign.

Land acquisition problems have plagued producers and industrialists in India and is the primary hurdle in setting up new ventures. Under Modi, the government passed an executive order (an "ordinance" in India) to ease land acquisition in critical sectors, including power, housing, and defense, reinvigorating some of the $300 billion in projects that had been held up due to the land acquisition laws.5



Furthermore, to signal seriousness in opening up the Indian economy further (see Figure 2), Modi passed two more ordinances increasing foreign firms' access to insurance ventures and commercial coal mining, which the country relies upon to provide a majority of their electricity. By opening up to foreign competition, Modi seeks to provide electricity to the millions of Indians who still live in the dark and to the industries that will need a consistent supply of energy if they are to "Make in India".

In 1990, the average Indian citizen had slightly more income than the average Chinese citizen, as measured by GDP per capita.

Getting the Fiscal House in Order

India has balanced a budget at the federal level only once in the last 25 years. The previous government poured endless rupees into wasteful subsidies, and in one year, 2003, had a primary deficit of 5.5% of GDP. This fiscal deficit caused Standard & Poor's to give India a credit rating that is just one notch above "junk" status (India is Baa3/BBB-/BBB-, upgrade watch by S&P). Modi has the government on track to cut the deficit to 4.1% of GDP in 2015, but a budget surplus remains elusive. India has not posted a budget surplus since 2007.

How will the government control its spending problem? The answer lies in revenues and subsidies. In order to raise revenues, Modi promised to divest from state-owned enterprises. He started this with a 10% sale of the coal-mining giant, Coal India, raising funds to fill state coffers.

On the side of wasteful subsidies, Modi took advantage of the timing of falling oil prices to remove costly diesel fuel subsidies, which accounted for a quarter of the government's total subsidy bill. In order to be more efficient with the subsidies still being disbursed, the Indian government opened bank accounts for 18 million poor people (almost the population of the State of New York) in a week in order to make sure subsidies reach their destination. To date, they have opened 115 million bank accounts.6

What Next?

We have here presented an optimistic case for India. But Modi's popularity and upstart presence alone are not enough to solve all of India's problems. For example, inflation, were it not for the decline in crude oil prices, might still be running too high.

Land acquisition problems, though worked on by Modi thus far, stand to face considerable opposition. And while a 4% budget deficit might be desirable compared to recent years, the central government still has a long way to go to balance the budget. Consider that the International Monetary Fund does not forecast a general government primary surplus over the next few years. The new government last month pushed out the date for a budget surplus to 2017, moving the budgetary goal posts once again.

As is the case with any democratic system, politicians do not win votes on nuance or plausibility. But, ultimately the history books will determine whether Modi's promises were substantive or just fanciful. Does he have the ability needed to execute on thorny issues like subsidies, land acquisition, and bureaucratic reforms? We will see.

After a great decade as Chief Minister of Gujarat, Modi hopes to replicate his efforts in New Delhi. With Modi at the helm, India has a renewed sense of hope for its economic future.

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Spain, Article: "No fear of deflation"

Sinking prices are not a problem for the entire economy

By Philipp Bagus, Assistant Professor for macroeconomics at the Universidad Rey Juan Carlos at Madrid, Spain. Just now, his book "In Defense of Deflation" has been released (Springer Wissenschaftsverlag, 2015), from Frankfurter Allgemeine Zeitung, Frankfurt, Germany, May 4, 2015

In the course of the European monetary easing, started by Mario Draghi (quantitative easing, QE), the European Central Bank is planning to purchase securities for 1.1 billion Euro, first of all government bonds. For this unprecedented action, the European Central Bank needs convincing arguments. One argument is the low rate of price increases in the Eurozone. A "sliding down" into "deflation" should be avoided by all means. The deflation-zone is suggested as quicksand meaning to have hardly escape and gradual ruin.

It is said that a security distance of inflation is needed from the number zero which would be achievable by QE.

How far this fear of deflation is scientifically tenable? Does price deflation mean a problem for the entire economy? Intuitively, favourable prices seem to be no problem. Purchasers are happy about lower prices. But now, we are not only purchasers, but also sellers of goods and services. And as sellers we are preferring higher prices. Concerning the general decline in prices, the individual person can win or lose. The positioning of everyone depends on the fact how the prices change relatively to each other: either the individual purchasing prices are falling faster or the selling prices. The purchasing prices of one are the selling prices of the other one. What one wins, the other one loses. In an aggregate, there is no problem.

For corporations, a positive profit margin is decisive, and this can be the case at higher or at lower price levels. If the purchasing prices are falling faster than the sales prices, the real profit situation will improve even in a price deflation. Of course, the state can also cause economic distortions during a price deflation, when its interventions prevent the falling of certain prices. Then, the falling prices are not responsible for the involuntary lying idle of resources but the state, which is holding against the sinking of individual prices with its interventions.

Often one may hear a more sophisticated argument against price deflation: Not the falling prices themselves would be the problem, but the expectation of falling prices. Consumers would defer consumption while expecting falling prices, corporations would then make losses. Hardly one will not buy gasoline for a full year by assuming that the gasoline price will be lower at 10 % the following year. In the technology sector, the prices are sinking continuously without leading to shrinking capital expenditure and to a crisis. Quite the contrary: The sector is flourishing. The consumers are knowing that prices for technology are falling continuously. The price-performance-ratio is improving. In spite of this the volume sale of computers and digital cameras is flourishing. Corporations are investing in the latest

IT. Consumers want to use the products and services and corporations want to create competitive advantages with them, this rather sooner than later.

A last argument against a general sinking of prices notes, that at least some costs are fixed at a medium-term and this may lead to losses, even with manageable business models. Especially debts are fixed nominally. With the sinking of prices, it is more difficult for debtors to service their nominally fixed debts. However, also here is true: the losses of the debtors are countervailed by the profits of the creditors because the interest income of the creditors has now a higher purchasing power. What the one loses, the other one wins.

In the extreme case, the debtor can get bankrupt. Should this bankruptcy not be disadvantageous? Also here, it is not the case from the perspective of the entire economy. The bankruptcy of the debtor due to sinking prices will not pauperise community. There will only be a change of owner. Old owners are losing the control to their creditors, from the point of view of the total economy, the production potential is not affected thereby. When a producer is bankrupted by his disability of paying debts, his factory and machinery equipment will not disappear, then. The bankruptcy only means a redistribution and a change of ownership. If the business model itself is sustainable, the new owners will continue the production.

The losses of debtors in a price deflation are explaining their aversion against falling prices. The financial industry, highly indebted large corporation groups and especially the state as the biggest debtor have a great interest to declare price deflation being a terrible catastrophy. Significantly, these actors are first and foremost profiting of their propagated remedy: the inflation – respectively the currently executed quantitive easing of the monetary policy by the European Central Bank.

Unfortunately, the cause of falling prices is often neglected in the debate of price-deflation. Falling prices can be the consequence of increasing productivity. It is a wide-spread myth that a growing economy shall need more money. If more or better products are produced, there will simply be a tendency to falling prices – the most natural development in a healthy national economy and the rule in the second half of the 19th century. Also the latest study of the Bank for International Settlement cannot find negative effects of falling prices concerning the growth of the economy.

A further kind of deflation is the credit deflation, going along with a falling money supply. In connection with an artificial upturn, bubbles and failed investments, it is able to accellerate and enforce a crisis of adjustment, so that distortions of the boom phase will be corrected faster. However, this kind of deflation is not responsible for failed investments, it will bring them earlier to light. If this deflation is prevented by the creation of new money, failed investments and wrong developments will continue for a longer time. New bubbles can be created. And it will lead to a redistribution. To justify a redistribution by way of monetary policy as QE implies, the deflation is wrongly represented as a danger for the entire economy.

from Frankfurter Allgemeine Zeitung, Frankfurt, Germany, May 4, 2015. Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

UNLOCKING INVESTMENT

The European Commission has unveiled its plans to create a Capital Markets Union. Philip Smith examines the implications

ILLUSTRATION: IMAGE SOURCE

In February, EU Commissioner Lord Hill launched a three-month consultation on his ambitious Capital Markets Union (CMU). It is a bold initiative that bids to improve business access to finance through deeper, liquid and more integrated capital markets.

The green paper, *Building a Capital Markets Union*, sets out the options that could be available, and the policy levers that need to be pulled, in order to create a Europe-wide finance market. This market would give businesses and investors greater opportunities throughout the 28 member states, irrespective of borders and nationality.

It is ambitious in timing and in scope; Lord Hill is aiming to develop an action plan that will put in place the building blocks for a fully functioning capital markets union by 2019. That is only four years away.

Great expectations

The ambition in scope is laid bare in the green paper. "The direction we need to take is clear: to build a single market for capital from the bottom up, identifying barriers and knocking them down one by one," says Hill, who is responsible for financial stability and financial services as well as CMU. "Capital Markets Union is about unlocking liquidity that is abundant, but currently frozen, and putting it to work in support of Europe's businesses, and particularly SMEs. The free flow of capital was one of the fundamental principles on which the EU was built. More than 50 years on from the Treaty of Rome, let us seize the opportunity to turn that vision into reality."

The paper sets out four objectives that the Commission is aiming to achieve

through CMU. First, it wants to improve access to finance for all businesses and infrastructure projects across Europe. Second, it wants to help SMEs raise finance as easily as large companies. Third, the Commission is aiming to create a single market for capital by removing barriers to cross-border investments. Finally, there is a desire to diversify the funding of the economy and reduce the cost of raising capital.

Simon Lewis, chief executive of the Association for Financial Markets in Europe, welcomes the proposals, saying: “Capital Markets Union is an essential reform project to revive the EU economy, and the financial industry can and will make an important contribution.” He adds that he particularly welcomes the emphasis that Lord Hill is placing on securitisation and the Prospectus Directive (a directive specifying the requirements for prospectuses that are prepared for investors when securities are issued), both of which are subject to separate consultations in the coming months.

Lewis’s views are echoed by Sally Scutt, deputy chief executive of the British Bankers’ Association (BBA), who says that the initiative is extremely important for the EU’s attempts to kick-start growth in Europe. “We would like the final proposals to reduce fragmentation and increase the depth of Europe’s capital markets, which will lower the cost of capital, improve its allocation and ultimately better support Europe’s growth companies to create jobs,” she says.

It has, however, also been suggested that there could be resistance to CMU among certain sections of the banking community, particularly those regional banks that are focused on national markets and medium-sized companies. But the BBA believes there is little to fear because it does not see banks and capital markets as competitors; it sees them as complementary.

Yet Scutt warns that the proposals need to be seen in the context of other EU plans that could prove counterproductive. “Introducing a financial transaction tax or restricting banks’ ability to conduct market-making activities for their clients through further structural reform could undermine attempts to inject greater liquidity into capital markets,” she says.

Problems and pitfalls

So what are the real problems that CMU is trying to address, and what are the pitfalls that could lie ahead? As Hill says, the free movement of capital was enshrined in the Treaty of Rome more than half a century ago. But the European Commission argues that capital markets today remain fragmented and are typically organised on national lines. This was brought into sharp relief following the financial crisis of 2008, since when the degree of financial market integration across the EU has fallen, with banks and investors retreating to home markets.

So, from a position of heading towards a unified market, similar to that seen across the Atlantic in the economic powerhouse of the US, Europe appears to have turned around, and is heading back towards a position of 28 smaller markets with less liquidity, and therefore less investment and capital available to be put to use by business to help achieve the Commission’s stated aim of creating more jobs and economic growth.

The differences between the US and European environments are laid bare in *The EU IPO Report: Rebuilding IPOs in Europe*, a new report from the EU IPO Task Force, a group led by quoted company membership association European Issuers, the European Private Equity & Venture Capital Association and the Federation of European Securities Exchanges. Highlighting the ‘lost investment’ in the European economy, the report compared the actual levels of certain investments (such as leverage loans, high-yield bonds, initial public offerings (IPOs) and private equity (PE)) with their potential size if European capital markets were as big relative to GDP as in the US.

The report reveals that there was some $3,725bn ‘lost’ in leveraged loans, $775bn in high-yield bonds, $110bn in IPOs and $390bn in PE. Quite some difference.

As MEP Philippe de Backer, chairman of the Task Force, says: “In order to deliver a Capital Markets Union in Europe that can provide more diverse funding sources for companies and cut the cost of raising capital, notably for smaller companies, we need policymakers, regulators and industry to work together to deliver reforms to regulation, to the tax regime and to market practices that will make IPO funding through the public markets accessible to all European companies.”

Although the report focuses on IPOs, its conclusions cut across the whole equity and capital piste. It calls for a more balanced and flexible regulatory environment, easing of constraints that restrict investors’ access to markets, improved tax incentives and

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KEY PRINCIPLES

The European Commission’s green paper identifies the following key principles, which should underpin a Capital Markets Union:

- **It should maximise the benefits of capital markets for the economy, growth and jobs;**
- **It should create a single market for capital for all 28 member states by removing barriers to cross-border investment within the EU and fostering stronger connections with global capital markets;**
- **It should be built on firm foundations of financial stability, with a single rule book for financial services that is effectively and consistently enforced;**
- **It should ensure an effective level of investor protection; and**
- **It should help to attract investment from all over the world and increase EU competitiveness.**

“We would like the final proposals to reduce fragmentation and increase the depth of Europe’s capital markets, which will lower the cost of capital, improve its allocation and ultimately better support Europe’s growth companies to create jobs”

a market system that better serves companies at different stages and different types of investors.

But, perhaps most importantly, it calls for the creation of an equity culture in Europe through education and non-legislative initiatives.

Emphasis on equity

This last conclusion is an area that needs to be tackled head-on if the CMU idea is to gain any traction, according John Grout, ACT's policy and technical director. "It is very important to start to educate the whole of Europe about equity," Grout says. "If you are going to set up a European-wide capital market for both equity and bonds, you are starting with a low level of education in much of Europe. If the Commission does not come up with soft actions rather than hard law, it will fail."

It is one of several points highlighted in a European Commission staff document that accompanied the publication of Lord Hill's green paper. The briefing paper recognises that Europe has traditionally relied more on bank finance, with European total bank assets far exceeding those of the US. But even this hides wide variations between different countries and their appetite for equity investment. For example, domestic stock market capitalisation exceeded 121% of GDP in the UK, compared with less than 10% in Latvia, Cyprus and Lithuania.

Grout warns that expectations must be realistic, and that change will not happen overnight, and perhaps not for many years. "If there is an expectation that they will get much done in less than a generation, they will fail. If there is not a real understanding of what equity is and what it does, why you might invest in it and how you might invest in it if you are a smaller investor, it could take 20 years for people to become used to it."

The staff paper also notes that more than 60% of EU citizens surveyed in 2013 stated that they had lost confidence in the financial sector as a result of the financial crisis. This low level of confidence, the paper says, hinders the flow of savings into capital market instruments.

Who's the boss?

One way to solve this lack of confidence problem would be to address issues over supervision. Significant progress has been made in strengthening the regulation and supervision of capital markets across the EU. But, as the staff paper itself concedes, while there has been considerable progress in harmonising rules needed for the transparency and integrity of securities markets, legislation relating to investors' rights in securities is not yet harmonised. Different member states define securities in different ways. Some stakeholders argue that this hampers the integration of EU capital markets because investors in one member state cannot correctly assess the investment risk in another member state.

> "If you are going to set up a European-wide capital market for both equity and bonds, you are starting with a low level of education in much of Europe"

This is a point raised by Andrew Strange, financial services risk and regulation director at PwC. He says: "While there is an important role for the European Supervisory Authorities, firms will want to consider carefully which bodies should get responsibility under CMU. Already we have seen the Bank of England suggest that this is not necessary, and we expect regulators in the UK to oppose ceding additional powers. Firms across the EU will not welcome any further uncertainty, particularly the eurozone banks that are getting used to the reality of direct European Banking Authority supervision."

The House of Lords EU sub-committee on economic and financial affairs backs this view. The committee's chairman, Lord Harrison, says: "Of course, we need to tread carefully. A move to more diversified sources of funding needs

to go hand in hand with improved investor protection, and greater clarity for the consumer."

A further issue revolves around which companies could benefit from the CMU initiative. While the Commission talks about SMEs, it is clear that capital markets are really only relevant for mid-cap and larger companies. The costs of going direct to the markets for financing rather than to banks are significantly higher.

As Marte Borhaug, senior policy adviser on financial services for the Confederation of British Industry, told a stakeholder's meeting hosted by Lord Harrison prior to the release of the green paper, it was important to focus on who CMU was trying to help and ensure it was not just talking about SMEs in terms of their size, but whether they were growing and had the ambition to grow. She added that there were things that could be done to improve the market, but companies also needed to take the initiative to look for alternative sources of finance.

Learning curve

SMEs could still benefit, however. As Grout says: "If you further the ability of larger companies to take funding from the market rather than from banks, banks might need to look for something else to do, and that might mean lending to SMEs. It is a second tier effect."

So what will this mean for corporate treasurers? If the objective of the CMU is to reduce the reliance upon bank debt, then larger and mid-sized companies will have to go to the markets, argues Grout. "The relevance to treasurers is that they need to follow what is going on; they will need to work out how they are going to use capital markets and when they are going to use capital markets. How will they explain this to their boards?

"There will be a learning curve for treasurers, and the nature of their relationships with banks and the capital markets will change."

Philip Smith is a freelance journalist, editor of *London Accountant* and a contributing editor to *Accountancy*

PHOTOGRAPH: CHARLIE BEST

THE TREASURER'S VIEW

"The objectives of the proposals on Capital Markets Union are quite laudable," says James Kelly, head of treasury at pest controller Rentokil Initial. He notes that while there are some "big challenges" to the proposal, such as encouraging investment across borders and changing the preference for funding in-country, the benefits could be significant if the union is successful.

Kelly continues: "At the moment, euro markets are receptive to smaller trades, such as our recent €50m floating-rate note, but in more volatile markets, minimum deal sizes would be substantially higher. Creating a broader range of markets, including developing the private placement market and encouraging peer-to-peer lending, would reduce the risk for borrowers of either not being able to raise money or only being able to raise an amount that is substantially more than is needed."

He concludes: "Clearly, there's no guarantee of success and we've seen with the Single Euro Payments Area how timescales can slip. But, overall, these are initiatives that should be encouraged."

Vietnam

Area	331,210 km²
Population	93.4 million
Population density	289 people per km²
Gross domestic product	
Total (nominal)	US$171.4 billion
GDP, per capita (PPP)	US$4,000
GDP growth forecast 2015	5.6%
GDP growth forecast 2016	5.8%
Public debt to GDP	48.2%
Balance of trade (surplus)	US$781 million
Unemployment rate	1.3%

Capital city Hanoi

Main language Vietnamese

Attractiveness of economy to business Vietnam ranked 78 out of 189 countries on the World Bank's *Doing Business 2015* report, receiving high marks for dealing with construction permits and registering property, yet low marks for paying taxes.

Top export markets
European Union 17.7%
United States 17.2%
Japan 11.4%

Foreign direct investment
Vietnam recorded FDI (net inflows) of US$8.4 billion in 2012, a 12.5% increase over the previous year.

The manufacturing sector accounts for **70%** of exports

Infrastructure
Vietnam's infrastructure ranked 81 out of 144 countries in the World Economic Forum's *Global Competitiveness Report 2014–2015,* with the quality of its roads, railways, ports and air transport receiving a score of 4 or less (7 is best). It is turning to public-private partnerships for new infrastructure projects to make Vietnam more attractive to investors.

Education
Vietnam has a literacy rate of 93%. A UNICEF survey of young people found that 17% of respondents had only completed elementary school, while another 50% had completed just lower secondary school.

93% Adult literacy rate

Legal system
Vietnam's latest constitution was adopted on 15 April 1992, and has since been amended. The legal system is based on civil law. The president, the chief of state, and the prime minister, who is the head of government, lead the executive branch. The legislative branch is composed of the National Assembly. The Supreme People's Court is the highest court in Vietnam.

22% Corporate income tax rate

Corporate income tax
Corporations involved in the exploration and exploitation of oil and gas, along with the exploitation of rare precious natural resources, are subject to a higher corporate tax rate than other companies, ranging from 32% to 50%. The standard corporate income tax rate is set to decline to 20% from 22% on January 1, 2016.

Indirect taxes
Vietnam has a value-added tax of 10%, though certain areas, such as medical and agricultural goods, have a reduced rate of 5%. In addition, there is a consumption tax ranging from 10% to 70% on goods, such as cigarettes, beer and cars, as well as casinos and golf courses. Vietnam also has environmental and natural resources taxes.

Other taxes
Capital gains stemming from the sale of shares are subject to a tax rate of 22%, which will decline in January 2016 to 20%. There is also a withholding tax of 5% on interest.

Administration
Vietnam ranked 173 in the area of paying taxes in the World Bank's *Doing Business 2015* report. It takes companies 872 hours, on average, each year to prepare, file and pay their taxes in Vietnam.

International organization membership
Asian Development Bank (ADB), Asia-Pacific Economic Cooperation (APEC), G-77, International Finance Corporation (IFC), Organisation internationale de la Francophonie (OIF), United Nations (UN), World Trade Organization (WTO), among others

Transparency International's Corruption Perceptions Index:
31 out of 100 (100 is very clean)

For more information: *Worldwide Corporate Tax Guide 2015*

Sources: CIA, World Bank, The Saigon Times, EY, WTO, UN, WEF, Transparency International

IAFEI News June 25, 2015

IAFEI Executive Committee Meeting, IAFEI Board of Directors Meeting, October 13, 2015, Milan, Italy

45th IAFEI World Congress, 2015, Milan, Italy, October 14 to 16, 2015

Hosting IAFEI member institute will be the Financial Executives Institute of Italy, ANDAF

46th IAFEI World Congress, 2016, in Russia

Hosting IAFEI member institute will be the Russian Club of Financial Directors, RCFD
Location, and exact time, not yet determined.

The IAFEI Quarterly is kindly supported by TMI

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North of Milan Expo 2015